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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Under the Truth in Lending Act and Regulation Z thereunder, is an assignment of returned or unearned insurance premiums a "security interest" requiring disclosure on the face of an automobile retail installment sales contract?

2. As all decided case law and industry-wide commercial usage at the time of execution of the contract form *sub judice* supported *not* disclosing the assignment of returned or unearned insurance premiums as a "security interest", should any ruling to the contrary be made prospective only?

3. In a Truth in Lending action, is a creditor's counterclaim for the underlying debt compulsory under Rule 13(a)?

TABLE OF CONTENTS

	PAGE
Questions Presented	i
Table of Contents	ii
Table of Authorities	iii
Opinions Below	1
Jurisdiction	1
Statutes Involved	1
Statement of Facts	3
Reasons for Granting the Writ	6
I. The Decision Below is in Direct Conflict with the Tenth Circuit's Decision in *James* v. *Ford Motor Credit Company*	8
A. The Tenth Circuit, Unlike the Court Below, Correctly Decided this Issue by Ascertaining Congressional Intent	8
B. Disclosure of an Incidental Interest in Unearned Insurance Premiums is Inconsistent with Congressional Intent	11
C. The Decision Below Ignores the Federal Reserve Board's Regulations and Interpretations	13
II. The Decision Below, Unless Given Only Prospective Application, Will Cause Injustice and Hardship to the Consumer Credit Industry	15
III. The Decision Below that Ford Credit's Counterclaim Was Not Compulsory is in Direct Conflict with a Fifth Circuit Decision	18

PAGE

Conclusion 20

Appendix

Opinion of the Court of Appeals for the Seventh Circuit (March 20, 1980) A-1

Order of the Court of Appeals (March 20, 1980) A-28

Decision of the United States District Court for the Northern District of Illinois, Eastern Division (October 31, 1978) A-29

Supplemental Decision of the United States District Court for the Northern District of Illinois, Eastern Division (November 17, 1978) A-39

Decision of the United States District Court for the Northern District of Illinois, Eastern Division (June 5, 1979) A-42

Judgments of the United States District Court for the Northern District of Illinois, Eastern Division (June 15, 1979) A-45

Order of the Court of Appeals on Petition for Rehearing and Rehearing In Banc (April 22, 1980)A-47

Opinion of the Court of Appeals for the Tenth Circuit (June 24, 1980) A-48

Illinois Automobile Retail Installment Contract dated September 30, 1977 [following A-58]

TABLE OF AUTHORITIES

Cases

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 15, 17

Edmondson v. Allen-Russell Ford, Inc., No. C75-940A (N.D. Ga. 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) 5, 7, 8, 16

Ford Motor Credit Company v. Milhollin, ——U.S.——, 100 S.Ct. 790 (1980) 7, 9, 17

PAGE

Gennuso v. Commercial Bank & Trust Co., 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd*, 566 F.2d 437 (3rd Cir. 1977) 7, 16

James v. Ford Motor Credit Company, No. 78-1806 (10th Cir. June 24, 1980) 7-10, 13

McDaniel v. Fulton National Bank, 571 F.2d 948 (5th Cir.) *(en banc)*, *reh. denied*, 576 F.2d 1156 (5th Cir. 1978) 15

Moore v. New York Cotton Exchange, 270 U.S. 593 (1926) 19

Plant v. Blazer Financial Services, Inc., 598 F.2d 1357 (5th Cir.), *reh. denied*, 605 F.2d 555 (5th Cir. 1979) 8, 18-20

Rounds v. Community National Bank, 454 F.Supp. 883 (S.D. Ill. 1978) 14, 16, 17

Shanks v. Greenbriar Dodge, Inc., Civ. No. C75-1154A (N.D. Ga. 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978) . 16

Southern Construction Co. v. Pickard, 371 U.S. 57 (1962) 18

Whigham v. Beneficial Finance Co., 599 F.2d 1322 (4th Cir. 1979) 8

Statutes and Rules

Consumer Credit Protection Act, 15 U.S.C. § 1601 *et seq.* 3

Section 102, 15 U.S.C. § 1601 9

Section 128(a)(10), 15 U.S.C. § 1638(a)(10) 1, 9

Section 130(f), 15 U.S.C. § 1640(f) 17

Judicial Code, 28 U.S.C. § 1254(1) 1

Truth in Lending Simplification and Reform Act, P.L. 96-221, Title VI, 94 Stat. 168 ..... 12, 17

Federal Rules of Civil Procedure, Rule 13(a) 7, 18, 19

PAGE

Regulation Z and Federal Reserve Board Interpretations

Regulation Z, 12 C.F.R. § 226.2(gg) (1980) 2, 9, 13

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980) 2

Federal Reserve Board Staff Opinion No. 1066 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,406 (June 4, 1976) 14

Federal Reserve Board Staff Opinion No. 1263 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,736 (November 23, 1977) 17

Congressional Materials

S. Rep. No. 96-368, 96th Cong., 1st Sess. (1979) *reprinted in* [1980] U.S. Code Cong. & Adm. News 834 (May 1980 Supp.) 12

S. Rep. No. 96-73, 96th Cong., 1st Sess. (1979) *reprinted in* [1980] U.S. Code Cong. & Adm. News 878 (May 1980 Supp.) 11, 13, 17

Other

6 Wright and Miller, *Federal Practice and Procedure*, § 1410 (1971) 18

§ 1414 (1971) 19

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Petitioners, ANDERSON BROS. FORD ("Anderson Bros.") and FORD MOTOR CREDIT COMPANY ("Ford Credit"), pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this cause on March 20, 1980. That decision squarely presents three important issues, on two of which the Circuit Courts of Appeal are now split.

OPINIONS BELOW

The opinion of the Court of Appeals (A. 1-27) is reported at 617 F.2d 1278. The opinions of the District Court (A. 29-44) are not reported.

JURISDICTION

The Judgment of the United States Court of Appeals for the Seventh Circuit was entered on March 20, 1980. The order denying Defendants' timely Petition for Rehearing was entered on April 22, 1980 (A. 47). This petition was filed within 90 days of that date.

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

The statute and regulations involved in this case are:

Consumer Credit Protection Act, § 128(a)(10) (15 U.S.C.A. § 1638(a)(10)):

> **Sales not under open end credit plans.**
>
> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> • • •

(10) A description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

Regulation Z, 12 C.F.R. § 226.2(gg) (1980):

"Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980):

(b) *Disclosures in sale and nonsale credit.* In any transaction subject to this section, the following items, as applicable, shall be disclosed:

* * *

(5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be

> furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

STATEMENT OF FACTS

On September 30, 1977, plaintiffs Olga Valencia and Miguel Gonzalez purchased a used 1974 Ford Pinto from Anderson Bros. pursuant to an Illinois Automobile Retail Installment Contract (the "Contract"), a full-sized copy of which is attached at the end of this petition. The Contract was subsequently assigned for value by Anderson Bros. to Ford Credit. Under the Contract, the plaintiffs were obligated to make 24 monthly payments of $69.16. The plaintiffs never made any of the installment payments under the Contract.

As required by the Truth in Lending Act (the "Act"), 15 U.S.C. § 1601 *et seq.*, the face of the Contract (which is the "disclosure statement" under the Act) contained certain disclosures. In paragraph 12, the Contract disclosed the security interest acquired by Ford Credit as follows:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

In paragraph 17, which is contained on the reverse side of the Contract, the Contract requires the buyer to purchase and maintain in force physical damage insurance on the vehicle. That paragraph also provided:

> *Buyer hereby assigns to Seller any monies payable under such [physical damage] insurance, by whomever*

> *obtained, including returned or unearned premiums,* and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller. (Emphasis added.)

Under the assignment provision in the Contract italicized above, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt. The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles in order to obtain the return of unearned insurance premiums, thereby exposing lenders to the risk of uninsured collateral.

On May 3, 1978, the plaintiffs filed a two-count Complaint against Anderson Bros. and Ford Credit. The Complaint alleged that Anderson Bros. and Ford Credit violated the Truth in Lending Act and the Illinois Motor Vehicle Retail Installment Sales Act because the Contract allegedly failed, *inter alia,* to disclose a security interest in returned or unearned physical damage insurance premiums (hereafter "unearned insurance premiums").

By an opinion issued on October 31, 1978, the District Court dismissed the Complaint in this action in its entirety for failing to state any claim for which relief could be granted (A. 29-38). With respect to the assignment of unearned insurance premiums, the District Court reasoned:

> The assignment of unearned insurance premiums is not a security interest in the normal meaning of that

> term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents. (A. 31).

Referring to a provision of the Illinois Motor Vehicle Retail Installment Sales Act, the District Court noted:

> [I]t helps us construe the contract in the light of Illinois law, where it is to be performed, and makes it rather clear that unearned insurance premiums do not constitute a security interest in the automobile. (A. 32).

On November 17, 1978, the District Court issued a Supplemental Decision (A. 39-41) reinstating that portion of the Complaint which alleged that the assignment of unearned insurance premiums is a "security interest." The District Court based this reversal of its initial ruling on the decision in *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) (Mr. Justice White voting in favor of granting the writ).* Thereafter, on June 15, 1979 (A. 45-46), based upon a decision it rendered on June 5, 1979 (A. 42-44), the District Court entered summary judgment for plaintiffs holding that the assignment of unearned insurance premiums is a "security interest" that must be disclosed under the Truth in Lending Act and Regulation Z.

Shortly after the plaintiffs filed the Complaint, Ford Credit filed a Counterclaim against the plaintiffs. The Counterclaim alleged that the plaintiffs failed to make any payments due under the Contract and sought to recover the outstanding contract balance (less certain rebates).

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* There was no conflict between Circuits on this issue at the time this Court denied the petition for certiorari in *Edmondson*. As discussed *infra*, there is such a conflict now.

In its Opinion issued October 31, 1978, the District Court dismissed the Counterclaim when dismissing the Complaint in its entirety (A. 36-37). In its Supplemental Decision of November 17, 1978, the District Court reinstated the Counterclaim (A. 40). The District Court again dismissed the Counterclaim in the Judgment entered June 15, 1979, without explanation. (A. 45).

On March 20, 1980, the United States Court of Appeals for the Seventh Circuit rendered the opinion (A. 1-25) now sought to be reviewed affirming the District Court's decision of June 15, 1979. Judge Sprecher's opinion was accompanied by two expressly "reluctant" concurring opinions by Judges Cudahy and Swygert (A. 26-27) which noted in pertinent part that:

—the assignment provision at issue was "entirely incidental to the principal consumer credit transaction";

—requiring such provision to be disclosed as a "security interest" on the face of the contract could not be taken as seriously suggesting a furtherance of the underlying purposes of the Truth in Lending Act;

—the opinion requires "the prominent disclosure of a rather esoteric right" which if disclosed as a "security interest" merely "add[s] virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit"; and

—"the important ends of credit disclosure . . . [might] be obscured in a whirl of litigious gamesmanship" following the opinion.

REASONS FOR GRANTING THE WRIT

There are now extant millions of installment contracts identical to the contract here at issue. They involve billions of dollars of debt and potentially enormous aggregate penalties under the Act. In the Tenth Circuit these contracts

are perfectly lawful, but in the Seventh, Fifth and Third Circuits they are held to violate the Truth in Lending Act under a most technical reading.*

The conflict among Circuits is irreconcilable. The Ford Credit contract which was the subject of the Tenth Circuit's decision in *James* is identical in all material respects to the Ford Credit form contract at issue in the opinion below and in *Edmondson*, and the Tenth Circuit expressly rejected the result reached by the Third, Fifth and Seventh Circuits. Petitioners contend that only the Tenth Circuit has correctly followed this Court's reasoning in *Ford Motor Credit Co.* v. *Milhollin*, __ U.S. __, 100 S.Ct. 790 (1980), and the legislative history of the Truth in Lending Act.

Even if the Seventh Circuit's view were accepted, any such decision should have been made prospective only. The form of security interest disclosure fully complied with prevailing judicial precedents at the time the Contract was executed. This was the credit industry's form of contract. No federal purpose will be served by permitting retroactive application of the decision below, but grossly inequitable consequences are clearly threatened by such an application.

The opinion below involves yet another conflict among Circuits which is ripe for resolution by this Court, which the Seventh Circuit noted: a conflict between the Fourth and Fifth Circuits on the issue of whether a creditor's counterclaim for the underlying debt in an action brought under the Act is a compulsory counterclaim under F. R. Civ. P. 13(a) which must be decided in the same federal

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* *Compare James* v. *Ford Motor Credit Co.*, No. 78-1806 (10th Cir. June 24, 1980) (A. 48-58) (disclosure not required), *with* the opinion below; *Edmondson* v. *Allen-Russell Ford, Inc.*, *supra;* and *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977) (disclosure required).

action that resolves the debtor's Truth in Lending claim.* The opinion below rejected the analysis used by the Fifth Circuit and affirmed the District Court's dismissal of the counterclaim, thereby barring debt collection counterclaims from all Truth in Lending actions in the Seventh Circuit.

Only this Court can resolve these conflicts among the Circuits and settle these issues of tremendous importance to the nation's credit industry.

I. THE DECISION BELOW IS IN DIRECT CONFLICT WITH THE TENTH CIRCUIT'S DECISION IN *JAMES v. FORD MOTOR CREDIT CO.*

The decision below was the second of the three decisions by different Circuit Courts of Appeal which considered the same legal issue in connection with identical contract forms prepared by Ford Credit. The decision below and the Fifth Circuit's earlier decision in *Edmondson* held that Ford Credit's form contract violated the Act by not disclosing on the face of the contract the assignment of unearned insurance premiums contained on the contract's reverse side. In contrast, the Tenth Circuit's June 24, 1980 decision in *James* (A. 48-58) held that such disclosure was not required under the Act.

A. The Tenth Circuit, Unlike the Court Below, Correctly Decided this Issue by Ascertaining Congressional Intent.

The Act requires the disclosure of "[a] description of any security interest held or to be retained or acquired by

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* *Compare Plant* v. *Blazer Financial Services, Inc.*, 598 F.2d 1357 (5th Cir.), *reh. denied*, 605 F.2d 555 (5th Cir. 1979) (counterclaim is compulsory), *with Whigham* v. *Beneficial Finance Co.*, 599 F.2d 1322 (4th Cir. 1979) (counterclaim not compulsory).

the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates." 15 U.S.C. § 1638(a)(10). The Act does not define the term "security interest." Regulation Z, 12 C.F.R. § 226.2(gg), provides that "security interest" means "any interest in property which secures payment or performance of an obligation." The Regulation does not state whether the assignment provision at issue here constitutes such an interest.*

The Tenth Circuit in *James* properly focused its analysis on whether disclosure of such assignment provision would be in accord with the purpose of the Act, which is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit. . . ." 15 U.S.C. § 1601. Both the courts and Congress have recognized that placing too much detail in disclosure statements can defeat the purpose of the Act because the disclosure statements become unreadable.

The Tenth Circuit quoted with approval (A. 53) from *Milhollin, supra,* 100 S.Ct. at 798, as follows:

> The concept of "meaningful disclosure" that animates TILA (citation omitted) cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between "com-

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* The following *caveat* from this Court's recent *Milhollin* decision, 100 S.Ct. at 797, is applicable here:

> [L]egislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of legislative or regulatory silence.

> peting considerations of complete disclosure . . . and the need to avoid . . . 'informational overload.' "

The Tenth Circuit then analyzed the legislative history of the 1980 amendments to the Act (discussed *infra*) and concluded that "the Act does not require, and Congress did not intend it to require, an exemplification of that interest [in unearned insurance premiums]on the face of the installment contract." (A. 54).

The opinion below reached the opposite conclusion without any discussion of whether its holding would further the purposes of the Act. In fact, such holding is likely to frustrate those purposes. Requiring the lengthy assignment provision in paragraph 17 on the back of the Contract to be added to the straightforward language in paragraph 12 on the front of the Contract would only distract the debtor from the important fact that the financed automobile (the *real* "security interest") and the proceeds therefrom were at risk if he failed to pay. The fact that the debtor assigned unearned insurance premiums, if any,* to the lender, to be applied by the lender either to replace the insurance or to pay down the debtor's loan obligation, is of virtually no consequence to the debtor. It does not place his property at risk, and giving it the same dignity of disclosure as a security interest can only result in confusion.

These concerns were certainly not lost on the reluctantly "concurring" members of the panel below, as Judge Cudahy wrote:

> I do not read it [Judge Sprecher's opinion]as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. . . .

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* In the vast preponderance of cases unearned premiums are never collected by the creditor because they are earned during the life of the installment contract and the coterminous physical damage insurance policy. In the case at bar, there were no unearned insurance premiums since plaintiffs never paid any premiums.

> Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.
>
> To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit. (A. 26).

B. Disclosure of an Incidental Interest in Unearned Insurance Premiums is Inconsistent with Congressional Intent.

As noted above, Congress intended the Act to promote "meaningful disclosure of credit terms." However, Congress became concerned that overly technical judicial decisions were defeating that purpose by requiring too much complexity in disclosure statements. This concern was expressed in the Report of the Senate Committee on Banking, Housing and Urban Affairs, S. Rep. No. 96-73, 96th Cong., 1st Sess. 2 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 878, 879 (May 1980 Supp.):

> There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions.

On March 31, 1980, the President approved the Truth in Lending Simplification and Reform Act (the "Simplification Act") as Title VI of P.L. 96-221. 94 Stat. 132, 168. Under Section 614(a)(9) of the Simplification Act, 94 Stat. 179, where the credit is secured the creditor shall disclose "a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

The legislative history makes it clear that this section was intended *not* to require the disclosure of "incidental interests" such as an assignment of unearned insurance premiums:

> When a security interest is being taken in property not purchased as part of the credit transaction, the Committee intends this provision to require a listing by item or type of the property securing the transaction, *but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile *but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums,* rights arising under, or waived in accord with state law, accessions, accessories, or proceeds. (Emphasis added.)

S. Rep. No. 96-368, 96th Cong., 1st Sess. 30 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 834, 864 (May 1980 Supp.).

This amendment was designed to clarify Congress' intent in originally adopting the Act. As noted above, Congress was critical of the "highly technical judicial decisions" which have subverted the original purpose of the Act. Be-

cause of such decisions, creditors have felt compelled to issue lengthy disclosure statements "written in legalistic fine print," resulting in "a piece of paper which appears to be 'just another legal document' instead of the simple, concise disclosure form Congress intended." S. Rep. No. 96-73 at 3, [1980] U.S. Code Cong. & Adm. News at 879-80. After examining this legislative history, the Tenth Circuit in *James* was correct in concluding that Congress did not intend to require the disclosure of an assignment of unearned insurance premiums on the face of the installment contract. (A. 51-54).

C. The Decision Below Ignores the Federal Reserve Board's Regulations and Interpretations.

As previously noted, the Federal Reserve Board ("Board"), which interprets the Act, has defined "security interest" in Regulation Z, 12 C.F.R. § 226.2(gg) (1980), as "any interest in property which secures payment or performance of an obligation." The Regulation also gives some specific examples of what the Board had in mind:

> . . . security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

These examples make it clear that the Regulation focuses on security interests the purpose and function of which is to secure the debt—and not on interests in property which are incidental to the consumer transaction at issue. Read with deference to the principal of *ejusdem generis*, Regulation Z halts the Act's disclosure requirement well short of the sort

of incidental interest in property at issue here. The opinion below ignored the clear import of the Regulation.

The staff of the Board has explained that the purpose behind disclosure of Truth in Lending Act security interests is to inform the debtor that he may lose certain property in order to satisfy the debt if he defaults.* The right to receive unearned insurance premiums is wholly unrelated to the consumer's default or to satisfaction of the debt. The very existence of the unearned premiums depends upon the cancellation of coverage, a decision not automatically triggered by a default in payment of the underlying debt. Moreover, from the moment of issuance of physical damage insurance which names the lender as a loss payee, the property interests in the policy are at least joint, and in fact belong more to the lender than the debtor as long as the debt remains unpaid. Disclosure of the assignment of unearned premiums as a security interest would simply not serve the purpose for which the Board has said such disclosures are required by the Act—to let the borrower know what property *belonging to him* will be reachable on default.

In *Rounds* v. *Community National Bank,* 454 F.Supp. 883, 888 (S.D. Ill. 1978), Chief Judge Morgan applied such principles of construction to the regulatory scheme and concluded that it would transcend the mandate of the Act to require disclosure of an assignment of unearned premiums as a "security interest." Judge Morgan noted:

> Both the assignment of unearned premiums and the assignment of insurance proceeds do provide some benefit and protection to the lender. But neither of those provisions subject the debtor's property to any lien or any risk. Rather, the insurance provisions of the agreement are properly construed as being mutually

* Federal Reserve Board Staff Opinion No. 1066 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,406 (June 4, 1976).

protective of the interests of both the debtor and the creditor.

* * *

If such ephemeral interests are to be deemed to be security interests within the disclosure requirements of the Act, that determination should emanate from Congressional enactment or from a determination of the Board, not from a judicial decree.

II. THE DECISION BELOW, UNLESS GIVEN ONLY PROSPECTIVE APPLICATION, WILL CAUSE INJUSTICE AND HARDSHIP TO THE CONSUMER CREDIT INDUSTRY.

Although the dollar amount involved in this case is small, it would be misleading to ignore the staggering volume of transactions that may be subject to attack under a retroactive application of the decision below.* Ford Credit urges this Court to reverse the decision below, and thus prevent any further application of its doctrine—prospective *or* retroactive. But even if this Court agrees with the decision below, under the guidelines established by this Court in *Chevron Oil Co.* v. *Huson,* 404 U.S. 97, 106-07 (1971), only prospective relief is proper in this case since (1) the Contract complied with the judicial precedents prevailing at the time it was signed; (2) no purpose of the Act would be furthered by retroactive application of the decision; and (3) a retroactive decision would be grossly inequitable.**

The Seventh Circuit refused to give only prospective application to the decision below on the ground that the weight of authority at the time the Contract was executed did not support petitioners' interpretation of the Act. (A. 18-19).

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* There are 91 cases now pending against Ford Credit alone (including one brought as a class action) which raise the issue decided below.

** There is judicial precedent for giving only prospective application to a Truth in Lending decision. *McDaniel* v. *Fulton National Bank,* 571 F.2d 948 (5th Cir.) (*en banc*), *reh. denied,* 576 F.2d 1156 (5th Cir. 1978).

The Seventh Circuit is simply wrong in this analysis. That interpretation of the Act was shared by the entire lending industry, as is shown in the brief filed below by *amici curiae* General Motors Acceptance Corporation and the Consumer Banking Association. Moreover, an examination of the pertinent cases shows that petitioners' form of disclosure *complied* with the case law prevailing at that time.*

The issue decided below was before the Seventh Circuit for the first time. (A. 19). That decision constituted a sharp break from the first two decisions on this issue by district courts in the Seventh Circuit—Judge Morgan's decision in *Rounds* v. *Community National Bank,* 454 F.Supp. 883 (S.D. Ill. 1978), and Judge McMillen's first opinion below (A. 30-32)—which held that an assignment of unearned insurance premiums was not a "security interest" requiring disclosure under the Truth in Lending Act. These district court decisions are strong evidence that the judicial precedents available to the district courts (and the credit industry) as late as 1978 endorsed the form of disclosure made by petitioners here in 1977. When even the district courts sitting in the Seventh Circuit failed in 1978 to predict correctly how the Seventh Circuit would rule on the issue decided in its March 20, 1980 opinion, petitioners do

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* There were only three district court decisions before September 30, 1977 (when the Contract was executed) which dealt with the assignment of unearned insurance premiums under the Truth in Lending Act. In *Edmondson* v. *Allen-Russell Ford, Inc.,* No. C75-940A (N.D. Ga. 1976), *aff'd,* 577 F.2d 291 (5th Cir. 1978), *cert. denied,* 441 U.S. 951 (1979), the district court held that an assignment of unearned insurance premiums was a Truth in Lending Act security interest. However, that decision was soon overruled by *Shanks* v. *Greenbriar Dodge, Inc.,* Civ. No. C75-1154A (N.D. Ga. 1976), *rev'd,* 577 F.2d 296 (5th Cir. 1978). The third district court opinion on point, *Gennuso* v. *Commercial Bank and Trust Co.,* 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd,* 566 F.2d 437 (3d Cir. 1977), held that even if an assignment of unearned insurance premiums were regarded as a security interest, it need not be specifically disclosed on the face of a credit contract. *Shanks* and *Gennuso* were reversed *after* the instant contract was executed.

not understand how that court could conclude that its decision was "clearly foreshadowed" at the time the Contract was executed in 1977. Similarly, the fact that the Circuit Courts of Appeal are split today with respect to contracts identical in all relevant respects supports petitioners' position that the law was (and is) unclear on this issue.

Nowhere in the lengthy opinion below was there any explanation of how such decision would further the purpose of assuring "a meaningful disclosure of credit terms." The opinion below did not dispute that the violation of the Act alleged here is "purely technical," but concluded that the credit industry should address its concern about the technical nature of certain requirements under the Act to Congress or to the Federal Reserve Board, not to the courts. (A. 13).

The credit industry has pursued with mixed results the avenues suggested in the opinion below. The Federal Reserve Board has expressly refused to issue an *official* interpretation on this issue.* However, by adopting the Simplification Act, Congress has acted to "eliminate litigation based on purely technical violations of the Act." S. Rep. No. 96-73 at 17, [1980] U.S. Code Cong. & Adm. News at 892. But the Simplification Act will not become effective for two years. 94 Stat. 185. Therefore, until the effective date of the Simplification Act, only this Court's hand, guided by the *Chevron* standard, can avoid the unfairly harsh re-

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* Under § 1640(f) of the Act, creditors can rely on an official Board interpretation as a complete defense in drafting their contract forms. *Ford Motor Credit Co.* v. *Milhollin, supra,* 100 S.Ct. at 797. Instead, the staff of the Board, in an unofficial opinion, has instructed lenders to look to state commercial law for the answer. FRB Staff Opinion No. 1263 [1974-77 Sp. Rel. Trans. Binder] CONS. CREDIT GUIDE (CCH) ¶ 31,736 (1977). The District Court's first opinion below found that the assignment provision did *not* create a security interest under Illinois law (A. 30-32), a finding which has not been disturbed. *See also Rounds* v. *Community National Bank, supra.*

sult which would occur if the decision below—involving a purely technical and highly debatable claim under the Truth in Lending Act—were applied retroactively. Prospective application in this case would be in accord with the intent of both the legislative and executive branches of the Government as expressed in the Simplification Act.

III. THE DECISION BELOW THAT FORD CREDIT'S COUNTERCLAIM WAS NOT COMPULSORY IS IN DIRECT CONFLICT WITH A FIFTH CIRCUIT DECISION.

Under F.R. Civ. P. 13(a), a counterclaim is compulsory if it "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." The words "transaction or occurrence" should be given a liberal interpretation in order to carry out the goal of judicial economy which is embodied in Rule 13(a). 6 Wright and Miller, *Federal Practice and Procedure,* § 1410, at 40 (1971). It is undisputed that in this case both plaintiffs' Truth in Lending claim and Ford Credit's Counterclaim arose out of exactly the same transaction—the loan evidenced by the Contract.

As noted by this Court, the compulsory counterclaim rule "was designed to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters." *Southern Construction Co.* v. *Pickard,* 371 U.S. 57, 60 (1962). This goal will be frustrated if a creditor is required to assert its debt collection claim in state court even though the debtor has already filed a Truth in Lending action involving the same transaction in federal court. It makes little sense to burden the judicial system by adopting a policy that requires two lawsuits to resolve a dispute that could be settled in one.

The Fifth Circuit recently held in *Plant v. Blazer Financial Services, Inc.,* 598 F.2d 1357 (5th Cir.), *reh. denied,* 605 F.2d 555 (5th Cir. 1979), that a creditor's counterclaim for the underlying debt in a Truth in Lending action is com-

pulsory under Rule 13(a). The Fifth Circuit reasoned that a straightforward application of Rule 13(a) to such counterclaim "clearly suggests its compulsory character because a single aggregate of operative facts, the loan transaction, gave rise to both plaintiff's and defendant's claim." 598 F.2d at 1361. The Seventh Circuit's decision below expressly refused to follow the Fifth Circuit's analysis and held that Ford Credit's Counterclaim was not compulsory and should be dismissed. (A. 21-25).

The question of whether a counterclaim for the underlying debt is compulsory has great importance for Ford Credit and the entire credit industry. If such a counterclaim is compulsory, it falls within the ancillary jurisdiction of the federal courts.* On the other hand, under the Seventh Circuit's holding below, Ford Credit is required to bring a separate action on its debt claim in state court. Ford Credit will thus have to satisfy the judgment entered in favor of plaintiffs on their Truth in Lending claim (assuming *arguendo* that such judgment is not disturbed) before it can obtain a state court judgment in its favor in the amount of the unpaid loan. Ford Credit probably will be unable to collect anything from plaintiffs—even from the funds which it paid to them. This fundamental unfairness was recognized by the Fifth Circuit:

> Absent the opportunity to bring a counterclaim, [the creditor] could be forced to satisfy the debtor's truth-in-lending claim without any assurance that his claims against the defaulting debtor arising from the same transaction will be taken into account or even that the

* 6 Wright and Miller, *Federal Practice and Procedure* § 1414, at 69 (1971). Moreover, once ancillary jurisdiction over a compulsory counterclaim has attached, the court will retain jurisdiction to decide the counterclaim even when the plaintiff's claim is disposed of before trial. *Moore* v. *New York Cotton Exchange*, 270 U.S. 593 (1926).

> funds he has been required to pay will still be available should he obtain a state court judgment. . . .
>
> To permit the debtor to recover from the creditor without taking the original loan into account would be a serious departure from the evenhanded treatment afforded both parties under the Act.

Plant v. *Blazer Financial Services, Inc., supra,* 598 F.2d at 1364. In contrast, if both claims are litigated in the same proceeding, then offsetting judgments could be applied against each other. The same "evenhanded treatment" accorded to creditors in Truth in Lending actions in the Fifth Circuit should be made available to creditors in the Seventh Circuit.

CONCLUSION

For all of the reasons stated above, we urge the Court to grant a Writ of Certiorari to review the opinion in this case so that the Court may resolve the conflicts among the Circuits presented herein and introduce some certainty into an area of the law which has a profound impact on the nation's credit economy.

Respectfully submitted,

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July 21, 1980

OPINION BELOW OF THE COURT OF APPEALS

In the

United States Court of Appeals

For the Seventh Circuit

No. 79-1950

OLGA VALENCIA and MIGUEL GONZALEZ,

Plaintiffs-Appellees,

v.

ANDERSON BROS. FORD and FORD MOTOR CREDIT COMPANY,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 78 C 1718—**Thomas R. McMillen**, *Judge*.

ARGUED JANUARY 11, 1980—DECIDED MARCH 20, 1980

Before SWYGERT, SPRECHER and CUDAHY, *Circuit Judges*.

SPRECHER, *Circuit Judge*. Defendants, Anderson Brothers Ford and Ford Motor Credit Company (Ford), appeal from the district court's order finding them in violation of the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et seq.* and Regulation Z, 12 C.F.R. § 226.1 *et seq.*, and dismissing their counterclaim. This appeal presents three issues for our consideration. First, did defendants' failure to disclose an assignment of returned or unearned physical damage insurance premiums as a security interest violate the Act and Regulation Z. Second, if this court finds such a violation, should its ruling be given only prospective effect under the

doctrine of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Finally, did the district court properly dismiss without prejudice defendants' counterclaim for the balance of the debt allegedly owed by plaintiffs under the installment contract at issue in this case.

I

On September 30, 1977, in connection with the purchase of a used 1974 Ford Pinto from Anderson Brothers Ford, the plaintiffs signed an Illinois Automobile Retail Installment Contract. This contract was subsequently assigned for value to Ford Motor Credit Company. The contract revealed that the plaintiffs were borrowing a sum of $1340.00, over a twenty-four month period, at an annual rate of interest of 21.40%. Record on Appeal, Document No. 14, Appendix A.

The contract contains on its face the following disclosure with respect to retention of security interests by the creditor:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

Record on Appeal, Document No. 14, Appendix A. The reverse side of the contract contains a provision requiring the debtor to purchase and maintain physical damage insurance on the auto. While this insurance apparently may be purchased through the creditor and financed under the contract, the buyer is free to obtain such insurance elsewhere as well. Regardless of the source of the insurance, the contract provides that the debtor assigns to the creditor any returned or unearned premiums payable under the insurance policy. Such premiums may be used to purchase replacement insurance coverage or may be applied to the debt in the discretion of the creditor. Brief of Appellants at 9. In addition, the creditor is given authority to cancel the

insurance policy and release or settle any claim with respect thereto.[1]

Plaintiffs contracted to purchase the required insurance through Ambassador Insurance Company at an annual premium of $442.00. Because the auto was permanently returned to Anderson Brothers due to mechanical problems on October 17, 1977, no payments were made by plaintiffs on either the insurance policy or

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[1] The contract provides, in pertinent part:

> RISK OF LOSS—INSURANCE
> The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require.
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> * * *
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> If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

Record on Appeal, Document No. 14, Appendix A. The contract goes on to provide that a failure to maintain the required insurance constitutes a default giving rise to the creditor's rights of acceleration and repossession. *Id.*, ¶ 18.

the installment contract.[2] The policy was eventually cancelled for nonpayment of premiums.

On May 3, 1978, plaintiffs filed suit in the court below against Anderson Brothers and Ford, alleging various violations of the Truth in Lending Act, Regulation Z and the Illinois Motor Vehicle Retail Installment Sales Act, Ill.Rev.Stat. ch. 121½, § 561 *et seq.*, including defendants' failure to disclose the assignment of unearned insurance premiums as a security interest. On October 31, 1978, the district court dismissed plaintiffs' complaint for failure to state a claim on which relief could be granted. The court specifically found that an assignment of returned or unearned insurance premiums was not a security interest and thus need not have been disclosed as such on the face of the contract.

Subsequent to its October 31 decision, the district court was informed of the July 28 decision of the Fifth Circuit in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). On the basis of that decision, the district court reinstated that portion of plaintiffs' complaint which pertained to disclosure of the assignment of unearned insurance premiums as a security interest. The district court entered summary judgment for the plaintiffs on this claim on June 5, 1979, finding itself in agreement with *Edmondson* that an assignment of unearned insurance premiums is a security interest that must be disclosed under 15 U.S.C. § 1638(a)(10) and 12 C.F.R. § 226.8(b)(5). The court also dismissed plaintiffs' pendent state law claims. Defendants appeal from the district

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[2] In the court below, defendants argued that plaintiffs' failure to pay the required premiums somehow foreclosed any finding of a violation of the Act or Regulation Z. The district court rejected this argument, finding the payment or nonpayment of premiums irrelevant. Defendants apparently do not contest this ruling on appeal. As our recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), indicates, the fact that a debtor may have no present interest in property in which a security interest is claimed is irrelevant for purposes of the disclosure requirements of the TILA and Regulation Z. Slip op. at 3-6.

court's summary judgment order; plaintiffs do not appeal from the dismissal of their other claims.

Defendants also appeal from the district court's dismissal of their counterclaim. The counterclaim, filed shortly after plaintiffs filed the complaint, sought to recover the balance due from plaintiffs on the installment contract. The district court dismissed the counterclaim without prejudice in its judgment entered June 15, 1979. No explanation was given for the dismissal.

II

A

The federal Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, was enacted in 1968

> to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit . . . .

15 U.S.C. § 1601. The Act does not regulate consumer credit; rather, it requires disclosure of certain terms and conditions of credit before consummation of a consumer credit transaction. *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 874 (7th Cir. 1976). The Act is to be liberally construed to ensure achievement of its goal of meaningful disclosure. *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 262 (3d Cir. 1975).

One of the credit terms which must be disclosed under the Act is the retention or acquisition of any security interest by the creditor in a consumer credit transaction. 15 U.S.C. § 1638(a)(10).[3] The Act, however, nowhere

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[3] The statute provides, in pertinent part:

> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> * * *
>
> (10) A description of any security interest held or to be retained or acquired by the creditor in connection

(Footnote continued on following page)

defines "security interest." The Federal Reserve Board, pursuant to the authority vested in it under 15 U.S.C. § 1604,[4] promulgated Regulation Z, 12 C.F.R. § 226.1 *et seq.*, which defines "security interest" as follows:

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[3] *continued*

with the extension of credit, and a clear identification of the property to which the security interest relates.

15 U.S.C. § 1638(a)(10). Regulation Z elaborates on this disclosure requirement as follows:

> (b) Disclosures in sale and nonsale credit. In any transaction subject to this section, the following items, as applicable, shall be disclosed:
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> * * *
>
> (5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the propery to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

12 C.F.R. § 226.8(b)(5).

[4] Section 1604 provides:

> The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the pur-

(Footnote continued on following page)

> "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien or property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

12 C.F.R. § 226.2(gg). The issue before this court is whether this definition encompasses a debtor's assignment to a creditor of returned or unearned physical damage insurance premiums.

This court is not the first court of appeals to address this issue. Both the Third and Fifth Circuits have held that an assignment of unearned insurance premiums is a security interest which must be disclosed under the TILA and Regulation Z. See *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979); *Shanks v. Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978); *Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977).[5] *Edmondson* is

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[4] *continued*

poses of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

15 U.S.C. § 1604.

The regulations promulgated by the Federal Reserve Board pursuant to this authority are entitled to deference by the courts and will be upheld as long as reasonably related to the purposes of the Act. *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369, 372 (1973).

[5] Defendants argue that *Gennuso* is not applicable in this case because it considered only the adequacy of disclosure of an assignment of unearned insurance premiums as a security interest and not whether such an assignment was a security interest at all. It is true, as defendants contend, that the *Gen-*

(Footnote continued on following page)

particularly damaging to defendants' case in that the contract at issue there does not differ in any material respect from the one now before us. Defendants do not attempt to distinguish *Edmondson*, but rather argue that it was wrongly decided and should not be followed by this court.

The heart of the *Edmondson* opinion, and the part which draws the greatest fire from defendants, is the Fifth Circuit's reliance on federal law, in the form of Regulation Z, rather than state commercial law to define a security interest for purposes of the TILA's disclosure requirements. Defendants argue that prior decisions of this court indicate that state law is to determine whether a security interest has been created requiring disclosure under the Act. See *Basham v. Finance America Corp.*, 583 F.2d 918, 924 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979); *Tinsman v. Moline Beneficial Finance Co.*, 531 F.2d 815, 818 (7th Cir. 1976).[6] Close examination of *Basham* and *Tinsman*

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[5] *continued*
nuso defendant conceded the assignment was a security interest for purposes of the Act. See *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461, 467 n.11 (W.D.Pa. 1976). However, the district court in *Gennuso* did not rely solely on this concession in finding that the installment contract created a security interest in the unearned premiums; the court specifically held that a security interest had been created and relied on the concession only for extra support. 425 F.Supp. at 467 & n.11. The Third Circuit noted its specific agreement with "the district court's determination that [the contract's provisions] create a security interest in the . . . unearned premiums of the insurance policy . . . ." 566 F.2d at 440 n.2. Both courts apparently considered this threshold issue properly before them despite the concession. Viewed in this context, *Gennuso* is a relevant precedent in the action before us. The Fifth Circuit was of the same opinion in *Edmondson*. See 577 F.2d at 294-95 & n.7.

[6] Defendants also cite *Croysdale v. Franklin Savings Ass'n*, 601 F.2d 1340 (7th Cir. 1979), as support for their contention that state law must be applied under the Truth in Lending Act. Reply Brief of Appellants at 10 n.*. This court looked to state law in *Croysdale* because of the Federal Reserve Board's deference to state rules of computation for certain transac-

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reveals, however, that this court looked to state law in those cases to determine the scope or extent of security interests clearly claimed by creditors, not to determine whether an unidentified interest was indeed a security interest. This court's recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), reveals that an interest may be a security interest for purposes of disclosure under the TILA even though it is not an enforceable security interest under state commercial law. *Id.*, slip op. at 3-4.[7]

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[6] *continued*
tions. 601 F.2d at 1347. We specifically noted that Congress did not intend to incorporate conflicting and uncertain state law rules into the Act. The state rules of computation were properly consulted in that case because the substantive law of the state involved "[did] not subvert the purposes of the Act or Regulation." *Id.*

[7] Defendants suggest that *Butner v. U.S.*, 440 U.S. 48 (1979), requires this court to apply state law to determine whether a particular interest is a security interest for purposes of the TILA. In *Butner*, the Supreme Court held that state law is to determine whether a mortgagee has a security interest in certain rents and profits, for purposes of the federal Bankruptcy Act. *Id.* at 54-55. *Butner* is not applicable here for several reasons. First, an interpretation of the Bankruptcy Act sheds little light on the proper interpretation of the TILA; the two statutes differ fundamentally in nature and purpose. Second, the definitions applied for purposes of the Bankruptcy Act determine the enforceability of creditors' rights; under the TILA, definitions control only disclosure, not enforceability of substantive interests. Indeed, a principal concern in *Butner* was that a federal definition conferred property rights not conferred by state law, *id.* at 56; in the TILA context, state law continues to govern the substantive aspects of property interests, while federal law merely classifies interests for disclosure purposes. There is thus no federal encroachment upon areas traditionally governed by state law. Finally, even under the *Butner* rule, state law is to govern "[u]nless some federal interest requires a different result." *Id.* at 55. The federal interest in uniform disclosure of credit terms requires a uniform federal definition of the terms to be disclosed. See, e.g., *Mason v. General Finance Corp.*, 542 F.2d 1226, 1231, 1233 (4th Cir. 1976). Regulation Z provides such a uniform federal definition.

The Fifth Circuit's decision in *Edmondson* followed *a fortiori* from its earlier ruling in *Elzea v. National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978). In *Elzea*, the court held that state law characterizations of interests are not determinative for purposes of the disclosure requirements of the TILA. *Id.* at 1249-50. The court analyzed the rights conferred on the creditor by the contract to determine whether they fell within the Regulation Z definition of "security interest": "any interest in property which secures payment or performance of an obligation." 12 C.F.R. § 226.2(gg). This definition provides a straightforward, two-step approach to classification of interests for disclosure purposes. In both *Elzea* and *Edmondson*, the Fifth Circuit applied this two-step approach and found that the interests involved were security interests for TILA purposes.[8]

The *Elzea* analysis, which focuses on the nature of the substantive rights conferred on a creditor rather than on state law characterizations of those rights, was recently endorsed and applied by this court in *Bulger, supra*, slip op. at 5-6. This approach to the definition of "security interest" is reasonable, straightforward in application and furthers the federal interest in uniform disclosure of terms and conditions of consumer credit transactions. See *Edmondson, supra*, 577 F.2d at 295. We will accordingly continue to follow this approach.[9]

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[8] In both *Elzea* and *Edmondson*, the Fifth Circuit referred to the creditor's interest as a valuable economic right or privilege. *Edmondson, supra*, 577 F.2d at 294; *Elzea, supra*, 570 F.2d at 1250. Defendants and amici focus upon these references as if they formed the basis for the *Elzea* and *Edmondson* decisions. Our reading of the cases, however, reveals that these references were no more than additional support for the conclusions reached by application of the Regulation Z definition. We do not read *Elzea* and *Edmondson* to hold, as amici and defendants suggest, that a valuable privilege in the hands of a creditor, without more, is a security interest for purposes of the Act.

[9] Our research discloses that every federal court to consider whether an assignment of unearned insurance premiums is a security interest for TILA purposes since *Edmondson* has ex-

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State law is not necessarily to be ignored in determining whether a creditor's interest is a security interest for TILA purposes. Indeed, the Regulation Z definition of "security interest" lists a variety of security devices recognized under state law as examples of security interests under the Act. 12 C.F.R. § 226.2(gg).

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[9] *continued*
pressed agreement with that decision. See *Arias v. Albuquerque National Bank*, No. 78-352 (D.N.M. Jan. 5, 1979); *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979); *Murphy v. Ford Motor Credit Co.*, No. 78-1091C (A) (E.D.Mo. Aug. 29, 1979). The *Murphy* case does not specifically mention unearned insurance premiums; rather, it refers to "any monies payable" under the insurance policy. The court's citation of *Edmondson* as support for its conclusion, however, suggests that an assignment of unearned premiums was encompassed within the assignment of "any monies payable."

Defendants urge us to reject the three court of appeals and three district court decisions which adopt a position contrary to their own in favor of "better-reasoned case law." This "better-reasoned case law" consists of *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978). Neither decision persuades us to reject *Edmondson* and its progeny.

James is unconvincing because it specifically addresses only an assignment of insurance proceeds and does not refer to unearned premiums. While this may be analogous to the issue before us, it is hardly persuasive in the face of decisions which are directly on point. *Rounds*, on the other hand, does deal with an assignment of unearned premiums and finds that it is not a security interest under Illinois law and thus need not be disclosed. 454 F.Supp. at 887-88. The *Rounds* decision has been criticized for its apparent misinterpretation of *Mims v. Dixie Finance Corp.*, 426 F.Supp. 627 (N.D.Ga. 1976), a decision on which it heavily relies. See *Hernandez, supra*, slip op. at 3; *Arias, supra*, memo. op. at 8-9. Even if the *Rounds* interpretation of *Mims* were correct, reliance on *Mims*, a decision from the Fifth Circuit, is inappropriate after *Edmondson* and *Shanks*. *Rounds* nowhere mentions the specific definition of "security interest" contained in Regulation Z, 12 C.F.R. § 226.2(gg), when, in fact, that definition should be the starting point for any analysis of the question. In light of these factors, we cannot agree with defendants' contention that *Rounds* and *James* represent "better-reasoned case law."

As post-*Edmondson* decisions addressing the precise issue before us recognize, state law can indicate whether a creditor possesses an interest in property securing performance of an obligation; if such an interest is found to exist, federal law defines it as a security interest. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5; *Arias v. Albuquerque National Bank*, No. 78-532 (D.N.M. Jan. 5, 1979), memo. op. at 6-8. A creditor's substantive rights are still governed by state law; federal law merely classifies those rights for disclosure purposes.

Application of the Regulation Z definition of "security interest" in this case, as in *Edmondson*, poses no special problems. It is not seriously disputed that the assignment of unearned insurance premiums confers on the creditor an interest in property. Even defendants refer to the assignment as an "incidental interest in property." Brief of Appellants at 8. Whether incidental or not, we agree with the Fifth Circuit that such an assignment is an interest in property. 577 F.2d at 294. Similarly, we agree that this property interest secures the performance or payment of an obligation. The assigned premiums may be used, in the sole discretion of the creditor, to purchase replacement insurance coverage or to pay part of the debtor's indebtedness. In either case, the assignment secures an obligation of the debtor.[10] *Id.* at

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[10] Indeed, defendants concede the assignment is intended to ensure that the insurance coverage which the debtor is obliged to obtain is maintained through the life of the installment contract. They state in their brief:

> Under the assignment provision in the Contract, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt.
>
> * * *
>
> The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles in order to obtain the return of unearned insurance

(Footnote continued on following page)

294. The creditor has the authority to cancel the insurance and cause payment of unearned premiums to itself at any time. The contract clearly gives the creditor an interest in property which secures performance of a debtor's obligations. Such an interest is by definition a security interest for TILA purposes, 12 C.F.R. § 226.2 (gg), and as such must be disclosed. Defendants do not suggest that such disclosure was made in the contract before us.

We reach this conclusion despite the protests of defendants and amici that such an interpretation of the TILA upsets established industry practice and will cause extreme hardship for what is, at worst, a purely technical violation. While industry practice can be a useful guide in defining terms used in the TILA in the absence of a definition in the statute or Regulation Z, *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 265-66 (3d Cir. 1975), reliance on industry practice is misplaced where, as in this case, a term is clearly defined in the regulation or the Act. As for the imposition of undue hardship on the industry as a result of a purely technical violation of the Act, we repeat our recent observation:

> Congress did not intend that creditors should escape liability for merely technical violations. . . . [W]hile it may be true, in some sense, as the creditors have argued, that the terminological violations here are inconsequential, the fact remains that they are violations. Any misgivings which creditors may have about the technical nature of the requirements should be addressed to Congress or to the Federal Reserve Board, not to the courts.

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[10] *continued*
premiums, thereby causing lenders to lose insurance protection on the real "security" for such loans—the financed vehicles themselves.

Brief of Appellants at 9. The contract provides that the debtor's failure to maintain this insurance is, like a failure to pay the indebtedness, a default giving rise to creditor's remedies for default. Record on Appeal, Document No. 14, Appendix A, ¶ 18.

Smith v. No. 2 Galesburg Crown Finance Corp., Nos. 78-2145, *et al.* (7th Cir. Jan. 15, 1980), slip op. at 15, *citing Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977). See also *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 578 (9th Cir. 1977).

We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue.[11] In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

B

Alternatively, defendants argue that even if an assignment of unearned insurance premiums must be disclosed as a security interest, they have an absolute defense, under section 1640(f), to liability under the TILA because they acted in good faith in conformity with published interpretations of the Federal Reserve Board. Section 1640(f) provides:

> No provision of this section or section 1611 of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or

[11] FRB Public Position Letter No. 377 (July 22, 1970). This letter is reproduced in full in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291, 295 n.8 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979).

> omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

15 U.S.C. § 1640(f). Defendants contend that the district court erred in rejecting this defense as a matter of law. They allege several specific errors to support this contention. First, the district court required that they prove actual reliance on a Federal Reserve Board regulation or interpretation, whereas section 1640(f) only requires "conformity with" such authority. Second, defendants' good faith is an issue of material fact under section 1640(f), thereby precluding summary judgment. Finally, the court, in rejecting the defense, addressed only one of the interpretations cited by defendants, ignoring defendants' conformity with other interpretations and Regulation Z itself.

We need not address defendants' first two objections,[12] because they failed in the district court and this court to make the threshold showing required under section 1640(f). To avoid summary judgment, a defendant relying on section 1640(f) may not rest on a conclusory allegation that it acted in conformity with Board interpretations. The defendant must point to specific regulations or interpretations which support its position. *Arias v. Albuquerque National Bank*, No. 78-532 (D. N.M. Jan. 5, 1979), memo. op. at 4; *Gillard v. Aetna Finance Co.*, 414 F.Supp. 737, 749 (E.D.La. 1976). Defendants have been unable to identify any such regulations or interpretations.

Defendants direct us to three sources as the foundation of their section 1640(f) defense. First, they argue that they acted in conformity with the Regulation Z

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[12] This circuit has not yet determined whether actual reliance is required under section 1640(f) or whether accidental conformity is sufficient. See *Basham v. Finance America Corp.*, 583 F.2d 918, 923 n.7 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Other circuits have required actual reliance. See, e.g., *Ives v. W. T. Grant Co.*, 522 F.2d 749, 758 (2d Cir. 1975). At any rate, it is not at all clear that the district court required proof of actual reliance.

definition of "security interest." 12 C.F.R. § 226.2(gg). As they read this provision, it does not include mere "incidental interests" such as that involved in this case. It is clear, however, that a creditor's mistaken interpretation of Regulation Z, even if honest and reasonable, is not a defense under section 1640(f). *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 579 (9th Cir. 1977).

Defendants also cite several official Board interpretations as support for their position that state law must be consulted to determine whether a security interest has been created. See 12 C.F.R. § 226.202; Official Staff Interpretation FC-0023, Appendix to 12 C.F.R. at 606-07; Official Staff Interpretation FC-0071, Appendix to 12 C.F.R. at 642-43; Official Staff Interpretation FC-0095, Appendix to 12 C.F.R. at 657-59. None of these interpretations concern interests even remotely similar to an assignment of unearned insurance premiums. Furthermore, as discussed in the margin, the interpretations do not stand for the proposition that the definition of "security interest" for purposes of the TILA is to be governed by state commercial law.[13] Defendants cannot rely on these interpretations to support their section 1640(f) defense.

Finally, defendants refer to Federal Reserve Board Staff Opinion No. 1263, CCH Cons. Cred. Guide ¶31,736 (Nov. 23, 1977). While this interpretation might be said

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[13] Interpretation FC-0023 does not address the definition of "security interest"; rather, it concerns only the adequacy of disclosure of an interest admitted to be a security interest. Interpretation FC-0071 concerns the adequacy of disclosure of a security interest; state law is relevant not to the creation of the security interest but only to its scope. The interpretation at 12 C.F.R. § 266.202 examines state law as to the substantive effect of judgment clauses and cognovit provisions. Such provisions are then classified as security interests according to their substantive effect under state law; this is precisely the *Elzea-Edmondson* approach adopted here. Finally, FC-0095 is a complex discussion of disclosure of security interests in consumer leasing transactions which neither clearly supports nor clearly refutes defendants' position.

to support defendants' position,[14] it is insufficient for section 1640(f) purposes for two reasons. First, it is an unofficial interpretation. This court has specifically held that conformity with unofficial staff opinion letters will not satisfy section 1640(f). *Basham v. Finance America Corp.*, 583 F.2d 918, 925 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Second, Opinion No. 1263 was issued after execution of the contract at issue here. A creditor cannot claim to have acted in conformity with an interpretation issued after the relevant transaction has been completed. *McGowan v. Credit Center of North Jackson, Inc.*, 546 F.2d 73, 77 (5th Cir. 1977). Thus, Opinion No. 1263 is of little use to the defendants in this case.

The district court properly rejected defendants' section 1640(f) defense as a matter of law. Defendants' failure to identify specific official Board interpretations or regulations which supported their position was fatal to this defense and rendered unnecessary any inquiry as to defendants' good faith or actual reliance. We accordingly affirm the district court's ruling that defendants violated the TILA and Regulation Z.

III

Defendants contend that if this court decides to affirm the district court's judgment, as it has, the ruling should be given only prospective effect except as to the plaintiffs. The circumstances under which a judicial decision will be denied full retroactive effect are defined in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971):

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly

[14] One court which addressed this precise contention found that Opinion No. 1263 did not support such a position and that it was not at all inconsistent with the result in *Edmondson*. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5, 7.

> foreshadowed . . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-07 [citations omitted]. Because prospective-only application is the exception rather than the rule, the party seeking to invoke *Chevron Oil* bears the burden of proving that such limited application is justified. *Jimenez v. Weinberger*, 523 F.2d 689, 704 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976). All three of the factors listed in *Chevron Oil* must be shown to favor prospective-only application before a decision will be denied retroactive effect. *Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287, 1294 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

The defendants have failed to bear their burden on this issue. They have convinced this court neither that our decision overrules clear past precedent nor that it resolves an issue of first impression whose resolution was not clearly foreshadowed. At the time the parties entered the transaction at issue here, only one lower court decision clearly supported defendants' position. *Shanks v. Greenbriar Dodge, Inc.*, No. C75-1154A (N.D.Ga. Dec. 16, 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978). Another decision in the same district had reached the opposite result, holding that an assignment of unearned insurance premiums was a security interest for TILA purposes. *Edmondson v. Allen-Russell Ford, Inc.*, C75-940A (N.D.Ga. Apr. 29, 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). Similarly, the district court in *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd*, 566 F.2d 437 (3d Cir. 1977), prior to the transac-

tion in this case, had ruled that such an assignment created a security interest; the court imposed no liability, however, because it found the disclosure in that case adequate. In addition, the only relevant Federal Reserve Board interpretation issued prior to this transaction, Public Position Letter No. 377 (July 22, 1970), counselled disclosure of an analogous assignment as a security interest. The decisions on which defendants place the greatest reliance, *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978), were both decided after the instant contract was executed and thus cannot be clear prior precedent on which defendants may have relied.

Our examination of these authorities reveals that, at the time of the execution of the contract in this case, clear precedent did not support defendants' interpretation of the TILA. In fact, the weight of authority, such as it was, favored the opposite interpretation. At the present time, the weight of authority, now quite substantial, is in accord with the result reached in this case. It likewise cannot be said that this decision resolves an issue of first impression in a manner not foreshadowed by earlier authorities. The issue, while before this court for the first time, had been considered by several federal courts prior to the instant transaction. At least one of those decisions, the district court's opinion in *Edmondson*, reached the result reached here. One other decision, by the district court in *Gennuso*, differs from our decision in this case only on the issue of adequacy of disclosure, not on whether the assignment created a security interest. The Federal Reserve Board's resolution of a closely analogous issue in Public Position Letter No. 377 suggested the same result. To say that our decision in this case resolved an issue of first impression in a manner not foreshadowed by earlier authorities is to ignore reality.[15]

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[15] Defendants cite *McDaniel v. Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978) (en banc) as proof that prospective-only application of judicial decisions interpreting the TILA is

(Footnote continued on following page)

Having decided that our ruling in this case establishes no new principle of law, it is unnecessay to address the remaining prongs of the *Chevron Oil* test. *Jordan v. Weaver*, 472 F.2d 985, 996 (7th Cir. 1973), *rev'd on other grounds sub nom. Edelman v. Jordan*, 415 U.S. 651 (1974). Nonetheless, we note that defendants have failed to persuade us that retroactive application of our ruling will retard the operation of the TILA or cause undue hardship. The Act requires disclosure of security interests as defined by Regulation Z. Our ruling merely implements that requirement. It does not disturb any clear rulings or precedents on which defendants may have relied to their detriment. We can see no inequity in its retroactive application.[16] We find, therefore, that

[15] *continued*
sometimes appropriate. *McDaniel*, while it may stand for that proposition, also indicates the limited circumstances in which such application will be decreed. Prospective application was ordered in *McDaniel* because the Fifth Circuit's decision in that case overruled an earlier decision by a panel of the same court. See *Martin v. Commercial Securities Co.*, 539 F.2d 521 (5th Cir. 1976). *McDaniel* is a far cry from the present case in which defendants can point to no clear rule in this or any other circuit on which they may have relied.

[16] As plaintiffs point out, defendants are not in an ideal position to claim that retroactive application of our ruling will cause undue hardship. Ford Motor Credit was a defendant in the *Edmondson* litigation. Ford learned on July 28, 1978, when *Edmondson* was decided by the Fifth Circuit, that at least one court of appeals considered its failure to disclose an assignment of unearned insurance premiums as a security interest a violation of the TILA. Despite this decision, Ford continued to use, in other circuits, a form contract which had been held to violate the Act in the Fifth Circuit. Ford was certainly entitled to do so since *Edmondson* was not the law in other circuits. However, in doing so Ford was gambling that its view of the law would prevail over the *Edmondson* view in subsequent suits. The fact that Ford now faces the consequences of losing its conscious gamble hardly presents a case of inequitable hardship. If the relevant provisions of Ford's contract had been modified in accordance with *Edmondson* within a reasonable time after that decision, Ford would be immune from any additional liability for this violation of the Act by virtue of the Act's one year statute of limitations. 15

(Footnote continued on following page)

prospective-only application of our decision in this case under the *Chevron Oil* doctrine is inappropriate. Defendants have failed to convince this court that any of the three *Chevron Oil* factors are present in this case.

IV

Defendants' final contention is that the district court erred in dismissing Ford's counterclaim for the balance allegedly owed by plaintiffs under the installment contract. Ford argues that dismissal was improper because the counterclaim is compulsory under Fed. R. Civ. P. 13(a).[17] It is clear that a compulsory counterclaim is within the ancillary jurisdiction of a district court and thus can proceed to trial even where the plaintiff's claim is disposed of prior to trial. *Plant v. Blazer Financial Services, Inc.*, 598 F.2d 1357, 1359 (5th Cir. 1979). A permissive counterclaim, however, cannot be entertained in federal court absent an independent basis for federal jurisdiction. *Whigham v. Beneficial Finance Co.*, 599 F.2d 1322, 1323 (4th Cir. 1979). There is no independent basis for jurisdiction over Ford's counterclaim in this case, so the issue is whether the counterclaim is permissive or compulsory.

There is a conflict between the Fourth and Fifth Circuits on this issue. The Fourth Circuit, in *Whigham*,

[16] *continued*
U.S.C. § 1640(e). The *Chevron Oil* doctrine is not directed at insulation of litigants from the consequences of their conscious business decisions; rather, its purpose is to avoid the hardship which can result from retroactive application of decisions which represent sudden, unexpected shifts in the law. This is not such a case.

[17] Rule 13(a) provides, in pertinent part:

> (a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.
>
> * * * *

Fed. R. Civ. P. 13(a).

supra, held that while a TILA claim and a debt counterclaim may, in a technical sense, arise from the same loan transaction, the two claims bear no logical relationship to one another. A debt counterclaim "has none of the characteristics associated with a compulsory counterclaim," 599 F.2d at 1323, and thus is permissive rather than compulsory. The Fifth Circuit has taken the opposite view. In *Plant*, *supra*, the court found that the claims are obviously interrelated and derived from a common factual basis; they are, therefore, logically related. On this basis the court held that a debt counterclaim is compulsory in a debtor's TILA suit. 598 F.2d at 1363-64. Both courts acknowledged that the majority of district courts to have considered the issue have ruled that debt counterclaims are permissive. See *Plant*, *supra*, 598 F.2d at 1361; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.[18]

The Fourth and Fifth Circuits both applied the "logical relationship" test to the debt counterclaims before them. This court considers the logical relationship test crucial in determining whether a claim and counterclaim arise from the same transaction or occurrence for purposes of Rule 13(a). We have observed that whether a particular counterclaim should be considered conpulsory depends not so much on the immediacy of its connection with the plaintiff's claim as upon its logical relationship to that claim. *Warshawsky & Co. v. Arcata National Corp.*, 552 F.2d 1257, 1261-63 (7th Cir. 1977). This test is to be applied flexibly in order to further the policies of the federal rules in general and Rule 13(a) in particular. *Id.* at 1261.

In *Plant*, *supra*, the Fifth Circuit analyzed the reasoning employed by many district courts to hold debt counterclaims permissive even where a literal application of the language of Rule 13(a) would suggest the opposite result. The primary concern of these courts was that enforcement of the TILA would be impaired if debt

[18] Both *Plant* and *Whigham* list the relevant lower court opinions. See *Plant*, *supra*, 598 F.2d at 1361-64, 1363 nn.10, 11; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.

counterclaims were compulsory because TILA plaintiffs would often be faced with counterclaims exceeding their potential recovery under the Act. In addition, TILA claims could not be expeditiously resolved if courts were entangled in the state law issues raised by debt counterclaims. 598 F.2d at 1361. The Fifth Circuit found that these and other concerns were outweighed by the interests in judicial economy and in providing complete relief to a defendant in a single lawsuit. *Id.* at 1363-64.

We disagree with the Fifth Circuit's analysis. The sole connection between a TILA claim and a debt counterclaim is the initial execution of the loan document. A flexible application of the logical relationship test reveals that this connection is so insignificant that compulsory adjudication of both claims in a single lawsuit will secure few, if any, of the advantages envisioned in Rule 13(a). As one court analyzed this issue:

> The link is credit extension, a fact established on the face of the pleadings, but the federal claim and state counterclaim do not stand on common ground when realistically assessed; the critical legal inquiry into each "half" of the controversy is so distinct that the parties' disputes are actually fragmented whether pursued through two actions or as separate aspects of one. In these circumstances, wooden application of the common transaction label does not yield real judicial economy; any perceived logical nexus is conceptual, abstract, a formal characterization rather than a recognition of concrete advantage to be achieved through single forum adjudication of all the parties' opposing claims. Even if inappropriate to weigh in the balance those policy considerations against federal court intervention, . . . in examining the state law counterclaim for purposes of Rule 13 this Court need not disregard the crucial factor of practical importance that the truth in lending complaint and debt counterclaim lack any shared realm of genuine dispute.

Ball v. Connecticut Bank & Trust Co., 404 F.Supp. 1, 4 (D.Conn. 1975) [citation omitted].

The TILA claim and debt counterclaim raise different legal and factual issues governed by different bodies of law. A TILA suit for inadequate disclosure, such as the instant case, can often be resolved by an examination of the face of the loan document. A debt counterclaim, on the other hand, can raise the full range of state law contract issues.[19] The two claims do not, as the Fifth Circuit held, spring from the same "aggregate of operative facts." *Plant, supra,* 598 F.2d at 1361. The rights and obligations of the parties with respect to the two claims hinge on different facts and different legal principles. We concur in the Fourth Circuit's characterization of the relationship between the claims:

> The lender's counterclaim alleges simply that the borrower has defaulted on a private loan contract governed by state law. The borrower's federal claim involves the same loan, but it does not arise from the obligations created by the contractual transaction. [citation omitted] Instead, the claim invokes a statutory penalty designed to enforce federal policy against inadequate disclosure by lenders.

Whigham, supra, 599 F.2d at 1324. Such claims are not logically related to one another and resolution of both in a single suit will not further the purposes of Rule 13(a).

Similarly, we concur in the Fourth Circuit's observation that permitting a creditor to "use the federal proceedings as an opportunity to pursue private claims against the borrower would impede expeditious enforcement of the federal penalty . . . ." *Id.* at 1324. In the absence of a relationship between the claims which will further the purposes of Rule 13(a), we decline to employ a mechanical interpretation of that rule in a way which will impede enforcement of an important federal statute.

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[19] It is true, as the Fifth Circuit observed, that a district judge is presumed competent to resolve such state law issues. *Plant, supra,* 598 F.2d at 1363, 1364. However, the fact that these issues can be capably resolved in a single suit does not indicate that they are best resolved in a suit raising federal claims unrelated to the substance of the loan agreement or any question of performance or default.

The result reached by the Fourth Circuit is consistent with prior decisions of this court[20] and the flexible approach to Rule 13(a) mandated in this circuit. Ford's counterclaim was dismissed without prejudice, so it is free to pursue its claim in state court. Accordingly, we affirm the district court's dismissal of Ford's counterclaim.

Having considered defendants' arguments and finding all without merit, we affirm the judgment appealed from in all respects.[21]

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[20] The Fourth Circuit in *Whigham* found that this court's decision in *Basham v. Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979), supported its conclusion. 599 F.2d at 1323 n.*, 1324. In *Basham*, we noted, in a different context, that a "TILA claim is not directed at or an answer to the underlying debt." 583 F.2d at 928. We also acknowledged that some district courts had found TILA claims and the underlying debt "not so related as to be the subject of a compulsory counterclaim . . . ." *Id.* at 928 n.18.

It is also interesting to note that in this portion of the appeal defendants ignore *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978), on which they relied so heavily elsewhere. In *Rounds*, the court dismissed the lender's counterclaim, observing that:

> This court has consistently held that a counterclaim upon the underlying credit obligation is not a compulsory counterclaim in a TILA action.

Id. at 890.

[21] We have examined *Ford Motor Credit Co. v. Milhollin*, 48 U.S.L.W. 4145 (Feb. 20, 1980), cited by defendants pursuant to Circuit Rule 11. As defendants state,

> *Milhollin* shows the critical importance of having a formal FRB interpretation that creditors may unhesitatingly rely upon as a complete defense under Section 1640(f) of the Act, . . .

In *Milhollin*, an official interpretation issued by the Board's staff directly supported the position taken by the defendant creditors. The Supreme Court found that section 1640(f) of the Act signalled a congressional decision to treat such official interpretations, whether by the Board or its staff, as authoritative. See 48 U.S.L.W. at 4148 & n.9. This "special status" was not, however, conferred under section 1640(f) upon

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CUDAHY, *Circuit Judge*, concurring. Judge Sprecher's opinion for the panel is exemplary in its logic, learning, legal analysis and lucidity of expression. But I do not read it as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. Among these meritorious purposes are the disclosure to buyers of the costs of credit and the alerting of customers to the possibility that their property may be reached to satisfy the obligation which they have incurred.

Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.

To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit.

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[21] *continued*
unofficial interpretations. See *id.* at 4148 n.10. In the present case, there is no official interpretation by the Board or its staff as to the proper treatment of an assignment of unearned insurance premiums. That such an interpretation might be desirable or even "critical" from the credit industry's viewpoint does not alter the fact that no official Board interpretation supports defendants' position in this case. The Board's failure to issue an official interpretation does not indicate that our ruling should be given only prospective effect. That decision is governed by the *Chevron Oil* criteria discussed in Part III, *supra*. Our examination of those criteria reveals that this is not an appropriate case in which to issue a prospective ruling. *Milhollin* does not require a different result.

As Senator Proxmire has said:

> "As sponsor of the original Truth in Lending Act I am becoming more and more concerned that its beneficial purposes are being frustrated by unnecessarily complex disclosure requirements which consumers may ignore or fail to understand.
>
> "In addition, the very complexity of the requirements may impose significant costs and other burdens on creditors despite their good faith efforts to comply with the law." 122 Cong. Rec. 23609 (1976).

I concur today with this Court's good faith efforts to apply (or comply with) the law, but I feel some concern about the purposes for which we are laboring. I hope that the important ends of credit disclosure will not be obscured in a whirl of litigious gamesmanship.

SWYGERT, *Circuit Judge*, concurring. Judge Sprecher's impeccable logic compels me to concur in his opinion and to approve the result we announce. I do so reluctantly, however, because of the concerns—which I share—that are expressed by Judge Cudahy in his concurrence.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

USCA 4512—Midwest Law Printing Co., Inc., Chicago—3-20-80—350

ORDER OF THE COURT OF APPEALS

MARCH 20, 1980

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

March 20, 1980

Before

Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

DECISION OF THE DISTRICT COURT

OCTOBER 31, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

Defendant Ford Motor Credit Co. filed a motion to dismiss the complaint in the above-entitled cause on June 9, 1978, subsequently supported by an affidavit of its Collections Supervisor dated June 15, 1978. The affidavit incorporates a true copy of the Automobile Retail Installment Contract upon which the complaint is based, and contains a statement of this defendant's policy and practice under paragraph 18 of the Contract, thus converting the motion to dismiss into one for summary judgment with respect to the matters contained in the affidavit. We find and conclude that no genuine issues of material fact are presented by the pleadings and that this defendant's motion to dismiss the complaint should be granted as a matter of law.

The complaint is typical of many filed pursuant to the Truth in Lending Act, 15 U.S.C. §1601 *et seq.* and Regulation Z thereunder, 12 C.F.R. ¶226 *et seq.*, adding a pendent claim pursuant to the Illinois Motor Vehicle Retail Installment Sales Act, Ch. 121½ §561 *et seq.* of the *Ill. Rev. Stat.* (1977). Plaintiffs sue for $639.68 statutory damages together with attorney's fees and costs, and also seek an

injunction restraining the collection of any finance charges, delinquency or collection charges, past, present or future, pursuant to the Illinois statute. Defendant counterclaims for the amount overdue on the contract.

We will deal with the five specific violations of the Truth in Lending Act alleged in par. 11 of the Complaint, and in doing so will dispose of the equivalent violations alleged under the Illinois statute. Defendant is alleged to have violated the Acts:

> (a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of Regulation Z § 226.8(b)(5) and 226.8(a).

Regulation 226.8(b)(5) requires specific disclosures to include:

> A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, . . .

The security interest complained of, according to plaintiffs' supporting memorandum, is described in § 17 contained on the reverse side of the Contract:

> RISK OF LOSS-INSURANCE
>
> • • •
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

If the foregoing § 17 of the Contract constitutes a "security interest" within the meaning of Regulation 226.8(b)(5), then pursuant to Regulation 226.8(a) it is an "obligation" which must be disclosed on the face of the contract above the customer's signature or on a separate statement which identifies the transaction. The better view, in our opinion, is that the assignment of proceeds of unearned premiums in § 17 of the Contract is not a security interest when viewed in the context of the contract or in the purchase and sale of automobiles. It is not similar to a chatel mortgage. It is not a lien on the automobile which must be disclosed on the certificate of title, need not be released in order to transfer clear title to the automobile, and can be used, according to § 17, either toward replacement of the automobile or payment of the purchaser's indebtedness.

It is instructive to note that a security interest is defined in § 12 of the Contract, above the purchaser's signature, as follows:

> Seller shall have a security interest under the Uniform Commercial Code in the Property [an automobile] and in the proceeds *thereof* to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder. [emphasis added]

This grants a security interest in the property itself and in its proceeds, in the event of a creditor's sale, and is the customary type of security interest retained on an installment contract for the purchase of an automobile. The assignment of unearned insurance premiums is not a security interest in the normal meaning of that term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents.

We also note a provision in § 570 of the Illinois statute, which must be read *in pari materia* with the Federal statute, as follows:

> If any required insurance for which an amount is included in the contract is cancelled, any unearned insurance refund . . . shall be credited on the final maturing installments of the contract except to the extent those amounts are applied toward payment for similar insurance protecting the interests of the buyer and the holder or either of them. . . .

In the case at bar, no insurance premiums were "included in the contract," hence the foregoing § 570 is not strictly applicable. Nevertheless, it helps us construe the contract in the light of lllinois law, where it is to be performed, and makes it rather clear that unearned insurance premiums do not constitute a security interest in the automobile. As with many other provisions, it provides an added protection to secure performance of the buyer's financial obligation under the contract, but below the level of a "security interest." See also *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. Dec. 16, 1976).

> (b) By failing to disclose a retained security interest in insurance proceeds in violation of Reg. Z, §§226.8(b)(5) and 226.8(a).

This retention is disclosed in § 12 on the face of the contract, quoted above, p. 4. For this reason, and for the reason that plaintiffs have not pointed out any reason why the assignment of insurance proceeds is any different, as a matter of law, than the assignment of unearned insurance premiums, defendant Ford is entitled to dismissal of this allegation of par. 11 of the Complaint.

> (c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for

a partial refund of the unearned finance charge in violation of Regulation Z § 226.8(b)(6) and (7).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of 15 U.S.C. § 1638(a)(9) and Regulation Z § 226.8(b)(4).

In these subparagraphs, plaintiffs complain about the provisions of § 18 of the Contract, contained on the reverse side from the signature page. This section provides for acceleration, upon default, of all amounts due or to become due, and incorporates all remedies available under the Uniform Commercial Code. It does not specify how unearned finance charges will be computed and whether or not they will be credited to the buyer. In this respect, plaintiffs rely upon 15 U.S.C. § 1638(a)(9) and 12 C.F.R. § 226.8(b)(4). Both of these require disclosure of "default, delinquency, or similar charges." In addition, 12 C.F.R. § 226.8(b)(6) and (7) apply to "penalty charges" and the computation of unearned finance charges upon *voluntary* prepayment of the principal. Defendant's contract computes only the latter.

The short answer to this contention is that an acceleration clause does not constitute a "charge" if the unearned interest is not retained by the seller. The overwhelming weight of authority is contrary to the plaintiffs' contentions. *Griffith* v. *Superior Ford,* 577 F.2d 455 (8th Cir. 1978); see also *McDaniel* v. *Fulton National Bank of Atlanta,* 571 F.2d 948, 950 (5th Cir. 1978) (en banc). The *Griffith* court rejects, as we do, the rather artificial approach taken by the Ninth Circuit in *St. Germain* v. *Bank of Hawaii,* 573 F.2d 572, 576 (9th Cir. 1977), to the effect that acceleration is equivalent to voluntary full prepayment and that, in the latter instance, the method of computing *any* un-

earned portion of the finance charge must be disclosed in the contract.

The Federal Reserve Board Staff's interpretation, issued on July 6, 1977 before the contract in the case at bar was executed, states in pertinent part:

> The fact that the contract is silent concerning rebate upon prepayment after acceleration is not determinative of the issue; the question is whether in fact the creditor does or does not rebate upon prepayment after acceleration in accordance with the rebate method shown on the disclosure statement. In this sense, then, the individual creditor's policy determines whether there is violation of the act and regulation.
> CCH *Consumer Credit Guide* ¶ 31,647 (July 6, 1977)

In the case at bar, the seller does not retain unearned interest upon prepayment in full, according to § 13 on the signature page of the Contract. This practice is not limited to voluntary prepayment under § 13 but also applies to payment of the full balance in the case of default, according to par. 2 of the defendant's affidavit. The affiant specifically states that, upon acceleration in the case of default, "it is the policy and practice of Ford Credit to collect from the debtors that portion of the finance charge which represents the period of time from the date the Contract was executed until the date that the balance owing on the Contract was paid." Paragraph 3 of the affidavit adds that, when the full balance is paid, the unearned portion of the finance charge is rebated to the debtor.

We give great weight to administrative interpretations which have the effect, after due consideration, of modifying previous positions taken by the administrative body. It was the letter of July 6, 1977, quoted above, upon which the Eighth Circuit relied in *Griffith* v. *Superior Ford,* supra p. 7, thereby disagreeing with the Fifth Circuit's decision

which had relied upon an earlier interpretation. *McDaniel* v. *Fulton National Bank of Atlanta,* supra, p. 7. Defendant's affidavit conforms to the Federal Reserve Board Staff letter of July 6, 1977 and is not controverted by any affidavit of the plaintiffs. There is no genuine issue of material fact on this issue and defendant is entitled to summary judgment on pars. 11(c) and (d) of the Complaint.

> (e) By failing to properly disclose Ford as a creditor in this transaction in violation of Regulation Z § 226.6(d).

The reference to Ford is alleged to mean the defendant Ford Motor Credit Co. The complaint here is based upon the following provision in Reg. 226.6(d):

> If there is more than one creditor or lessor in a transaction, each creditor or lessor shall be clearly identified....

The defendant Ford Motor Credit Co. is identified by name as the assignee of the contract on page 1, over the seller's signature. It is also identified by name in the executed Assignment on the reverse side of the contract. Section 15 on the reverse side of the Contract provides further:

> ASSIGNMENT
>
> The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

No provision of the statute or regulation requires that the terms of an assignment be set forth on the signature page, or that the creditor be identified there. Cf. Reg. 226.8(b)(4), (6) and (7). The only question therefore is whether or not defendant Ford Motor Credit Co. is "clearly identified" in the contract. We find and conclude that it is, since the two clauses referred to above must be read together.

It is difficult to understand what additional identification plaintiffs seek, since the defendant assignee replaces the seller in all respects and becomes *the* creditor at the outset. The better authorities, in our opinion, have approved the identification contained in this contract. *Antonio* v. *Canal Motors, Inc.*, No. 74-3163 (E.D. La. Nov. 17, 1977); *Sharp* v. *Ford Motor Credit Co.*, No. 77-1098 (S.D. Ill. June 8, 1978). The foregoing cases, although apparently not published in any reporter, are not disputed by the plaintiffs, and we take judicial notice of them. These and the other decisions cited herein without reporter references are attached to the defendant's reply memorandum filed July 27, 1978.

Pendent Count II. As mentioned above, Count II is filed under the Illinois Motor Vehicle Retail Installment Sales Act, the pertinent subsections of which are indistinguishable from the Truth in Lending Act and its accompanying regulations. In fact, the State of Illinois has patterned its regulations on Regulation Z for the interpretation of its statute. See *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 883-84 (7th Cir. 1976). If Count I fails to state a claim upon which relief can be granted against Ford Motor Credit Co., Count II must be dismissed for the same reason.

Conclusion. Defendant Ford Motor Credit Co. has filed a counterclaim against the plaintiffs to collect payments allegedly due under the installment contract. This is not a compulsory counterclaim under F.R.C.P. 13(a). Since we

will dismiss the complaint against this defendant, we will dismiss its State court cause of action against the plaintiffs also. *Rivera* v. *McGee,* 77 C 1168 and *Roman* v. *Z-Frank, Inc.,* 76 C 1065 (N.D. Ill. 1978).

Defendant Anderson Brothers Ford has filed a crossclaim against Ford Motor Credit Co. on the theory of an implied contract of indemnity. Defendant Ford Motor Credit Co. has filed a motion to dismiss the crossclaim. This motion has not been briefed, and Anderson Brothers Ford is still a defendant to the complaint. However, in view of our decision dismissing the complaint as to the Ford Motor Credit Co., and in view of the fact that exactly the same violations are charged against Anderson as we have ruled to be ineffective against Ford Motor Credit Co., we see no purpose in maintaining the complaint any longer against Anderson Brothers Ford. If the complaint is dismissed against both defendants, then the crossclaim of Anderson against Ford Motor Credit Co. likewise falls.

The Truth in Lending Act as applied to automobile purchases has spawned more litigation and taken more time of the attorneys and the court over relatively minor controversies than any other truth-in-lending action which we have encountered. Some of the plaintiffs have had the fortitude and financial ability to appeal these cases as far as the Courts of Appeals, with varying results. Most of the cases, however, do not proceed to that stage, and none which have been decided by the Seventh Circuit Court of Appeals involve the details and issues raised herein. The plaintiffs in this case are represented by the Legal Assistance Foundation of Chicago which is supported by public funds. Unless a more representative case is already available for the appeal process in this Circuit, we suggest that the case at bar be used as a test to lay at rest some of the troublesome problems raised by this complaint, concerning which there are a multitude of conflicting court decisions.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the motion of the defendant Ford Motor Credit Co. to dismiss the complaint pursuant to F.R.C.P. 12(b) is granted, the complaint against defendant Anderson Brothers Ford is dismissed *sua sponte,* the counterclaim of Ford Motor Credit Co. against the plaintiffs is dismissed, without prejudice, for failure of federal jurisdiction, and the crossclaim of Anderson Brothers Ford against the defendant Ford Motor Credit Co. is dismissed as moot. A rule 58 judgment will enter.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: Oct. 31, 1978

DECISION OF THE DISTRICT COURT
NOVEMBER 17, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

SUPPLEMENTAL DECISION

We have reviewed the discussion and conclusions under section (a) of our decision dated October 31, 1978 and have decided that they are erroneous. This review was instigated by a letter dated November 6, 1978 from counsel for defendant Ford Motor Credit Co. calling our attention to the recent decision in *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978) which also adopts the more definitive decision of *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978).

The *Shanks* decision reversed the unpublished decision which we had cited on page 5 of our decision of October 31, 1978. The *Edmondson* decision relies heavily on *Elzea* v. *National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978) which in effect supersedes *Mims* v. *Dixie Finance Corp.*, 426 F. Supp. 627 (N.D. Ga. 1976) on the definition of a security interest. On this point Judge Morgan relied heavily on *Mims* in *Rounds v. Community National Bank in Monmouth*, 454 F.Supp. 883 (S.D. Ill. 1978)

We are satisfied that the *Edmondson* and *Elzea* decisions are correct in holding that the assignment of unearned insurance premiums *is* a security interest under § 1638(a)(10) of the Truth in Lending Act. We are also satisfied that this security interest was not properly disclosed by defendants in accordance with ¶ 226.8(b)(5) of Regulation Z. We will not burden the parties with additional discussion of the reasons for this change other than to refer them to Judge Goldberg's persuasive and perceptive analysis in *Edmondson*.

Although the court in *Edmondson* and *Shanks* does not reach the similar issue regarding insurance proceeds, the rationale of these decisions also applies to the security interest discussed in par. (b) of our decision of October 31, 1978. However, it remains our opinion that this security interest is properly disclosed in Section 12 of the contract, quoted on page 4 of our decision. At least it is disclosed as to property damage or theft insurance, and the parties have not shown the existence of any other insurance covered by the disclosure in Section 12 of the contract.

In view of the foregoing, we have also reconsidered our dismissal of the other pleadings in this case, specifically this defendant's counterclaim, the complaint against Anderson Brothers Ford, and the crossclaim of Anderson against Ford Motor Credit Co. Since the plaintiffs' complaint is still partially viable, the other pleadings will also be reinstated and the Rule 58 judgment vacated. The plaintiffs' motion to dismiss the counterclaim will be reconsidered on its merits, no further briefing required.

The decision and order entered October 31, 1978 is vacated to the extent noted above. Defendants are ordered to file an answer to the complaint, the cross-defendant is ordered to answer the cross-claim, and plaintiffs' motion to dismiss

the counterclaim will be retained under advisement. All pleadings to be filed within ten (10) days hereof. This case will then be called for a report on status on Monday, December 4, 1978 at 11:30 a.m.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: Nov. 17, 1978

DECISION OF THE DISTRICT COURT
JUNE 5, 1979

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

All parties have filed motions for summary judgment in this case which involves alleged violations of the Federal Truth in Lending Act and the Illinois Motor Vehicle Retail Installment Sales Act. The total amount being financed by the plaintiffs is $1,340.00, and the finance charge is $319.84. This is the fourth contested motion that has been presented in this case and, we trust, the last. We will enter summary judgment in favor of the plaintiffs.

The principal issue to be decided is whether or not the assignment of unearned or returned insurance premiums is a "security interest" which must be disclosed in the purchase contract, pursuant to 15 U.S.C. § 1638(a)(10) and 12 C.F.R. 226.8(b)(5) of Regulation Z.

In our decision of November 17, 1978 that such an assignment must be disclosed, we relied on *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978). Certiorari was denied in that case by the United States Supreme Court on May 14, 1979. 47 U.S.L.W. 3744. For the reasons stated in our foregoing decision and in the decision entered December 13, 1978, we believe that *Edmondson* is a correct statement of the law.

Defendants contend that, since plaintiffs made no payments under the contract and paid no insurance premiums but instead rescinded the transaction and consequently caused the insurance policy to be cancelled, the provisions of the above statute and regulation do not take hold. This is a specious argument, because Regulation Z applies to the contract, both at the time it is signed and *in futuro*, requiring disclosures whether or not any payments are made by the purchasers.

Nor does the fact that plaintiffs rescinded the transaction prevent them from collecting damages. Merely a violation of the statute and its regulations is sufficient to create plaintiffs' cause of action under 15 U.S.C. § 1640. See *Mulqueeny* v. *National Commission, etc.*, 549 F.2d 1115, 1120, n.15 (7th Cir. 1977); *White* v. *Arlen Realty & Development Corp.*, 540 F.2d 645 (4th Cir. 1975).

Defendants' alleged reliance on various publications emanating from the Federal Reserve Board is misplaced. In the first place, defendants do not support their alleged reliance with any affidavit or evidence. In fact, the Board's unofficial position at the time plaintiffs' contract was signed appeared to require proper disclosure of defendants' interest. See Public Position Letter No. 377, quoted in *Edmondson*, 577 F.2d at 295, f.n.8. Secondly, Federal Reserve Board letter No. 1263 is not a regulation but is merely an unofficial staff interpretation which, incidentally, was not released until two months after the contract in this case was signed. It does not have the force of a regulation. *Basham* v. *Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978). Finally, since we have already determined that the assignment of insurance premiums, whether paid or unpaid, is a "security interest" within the meaning of the Federal statute and regulation, we need not be concerned with whether or not this definition is consistent with

local state law. The enforcement or effect of a security interest in the local state courts is quite another matter, not involved under the Truth in Lending Act.

Plaintiffs are directed to serve and file an appropriate judgment order in their favor and against defendants within ten (10) days hereof which will dispose of Count I of the complaint. The pendent State law action in Count II will be dismissed without prejudice upon entry of Judgment on Count I.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: June 5, 1979

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

JUDGMENT

A decision having been rendered on motions for summary judgment filed by all parties,

IT IS ORDERED AND ADJUDGED:

1. That plaintiff Olga Valencia recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

2. That the plaintiff Miguel Gonzalez recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

3. The issue of attorney fees and costs is reserved. Plaintiffs shall file a motion for an award of attorney fees and costs within 15 days of the date of this judgment.

4. The counterclaim of the defendant Ford Motor Credit Company is dismissed without prejudice.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: June 15, 1979

UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF ILLINOIS—
EASTERN DIVISION

Civil Action File No. 78 C 1718

OLGA VALENCIA, *et al*

Plaintiffs

vs.

ANDERSON BROS. FORD, *et al*

Defendants

JUDGMENT

This action came on for (hearing) before the Court, Honorable Thomas R. McMillen, United States District Judge, presiding, and the issues having been duly (heard) and a decision having been duly rendered,

It is Ordered and Adjudged that plaintiff Olga Valencia recover of defendants jointly and severally the sum of $639.68 with interest at the legal rate.

It is ordered and adjudged that plaintiff Miguel Gonzalez recover of defendants jointly and severally, the sum of $639.68 with interest at the legal rate and with costs of the action.

Counterclaim of defendant Ford Motor Credit Co. is dismissed without prejudice.

Dated at Chicago, Illinois, this 15th day of June, 1979.

H. STUART CUNNINGHAM
Clerk of Court

By: /s/ KATHLEEN BRANCH
Deputy Clerk

ORDER OF THE COURT OF APPEALS DENYING PETITION FOR REHEARING

APRIL 22, 1980

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

April 22, 1980.

Before

Hon. LUTHER M. SWYGERT, Circuit Judge

Hon. ROBERT A. SPRECHER, Circuit Judge

Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *in banc* filed in the above-entitled cause by defendants-appellants, no judge in active service has requested a vote thereon, and a majority of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

OPINION OF THE COURT OF APPEALS FOR THE TENTH CIRCUIT JUNE 24, 1980

UNITED STATES COURT OF APPEALS TENTH CIRCUIT

No. 78-1806

JODY JAMES AND BARBARA JAMES,

Plaintiffs-Appellants,

v

FORD MOTOR CREDIT COMPANY AND DEL NORTE MOTOR COMPANY,

Defendants-Appellees.

Appeal from the United States District Court for the District of Colorado (D. C. No. Civ. 78-F-647)

Richard J. Rubin (with him on the briefs were Paul L. Biderman and Timothy Meehan, attorneys for Northern New Mexico Legal Services, Inc. and Le Roy Cordova) for appellants.

Lawrence W. Treece (with him on the briefs were Holme, Roberts and Owen, and Richard L. Schrepferman and Jeffrey A. Chase) for appellees.

Before SETH, Chief Judge, BREITENSTEIN and DOYLE, Circuit Judges.

BREITENSTEIN, Circuit Judge.

This action, which arose in Colorado, seeks recovery of a statutory civil liability for failure to disclose in an automobile installment purchase contract the right of the seller to a returned and unearned insurance premium on a policy

covering physical damage insurance. The claim is made under the Truth in Lending Act, TILA, 15 U.S.C. § 1601 et seq. as implemented by Federal Reserve Board Regulation Z, 12 C.F.R. § 226. The district court granted a motion to dismiss and the plaintiffs-buyers appeal. We affirm.

The plaintiffs-appellants, Jody and Barbara James, purchased a pick-up truck from defendant-appellee Del Norte Motor Company and executed an installment purchase contract which was assigned to Ford Motor Credit Corporation. The contract shows a cash price of $5395.00, down payments of cash and trade-in totalling $900.50, and a balance due of $4,494.50. To this are added other charges consisting of $359.84 for insurance and $5.50 registration fee. Also added is a finance charge of $1,238.92, at an annual interest rate of 15.40%. The balance due is payable in monthly installments of $169.41.

Paragraph 13 of the signed face page of the contract reads:

> "Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and to the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due thereunder."

Paragraph 15 on the face page provides that the terms and conditions on the reverse side are incorporated by reference. Paragraph 18 on the reverse side relates to insurance and among other things provides:

> "Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, * * *. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the indebtedness hereunder in the sole discretion of the Seller."

TILA requires, 15 U.S.C. § 1631(a), that a creditor "clearly and conspicuously, in accordance with the regulations of the Board" disclose the information mandated by the Act. Reg. Z, 12 C.F.R. § 226.8(a) provides that all the disclosures be made on either:

> "(1) The note or other instrument evidencing the obligation on the same side of the page and above the place for the customer's signature; or
>
> (2) One side of a separate statement which identifies the transaction."

Failure to disclose properly the required information subjects the offender to a civil liability of not more than $1,000.00 plus reasonable attorneys' fees. 15 U.S.C. § 1640(a). The purchasers sue for the statutory liability and attorneys' fees. The trial court held that the assignment of the returned and unearned portion of the insurance premium was not a security interest under the Colorado version of the Uniform Commercial Code. See Colo. Rev. Stat. (1973) § 4-9-102.

TILA requires, 15 U.S.C. § 1638(a)(10), the disclosure of "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates." The Act does not define "security" or "security interest." Reg. Z provides, 12 C.F.R. § 226.2(gg):

> " 'Security interest' and 'security' mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust and [various liens and a lease interest securing performance of an obligation]."

The reference to the Uniform Commercial Code specifically declares that it is not a limitation. Although the interplay of federal and state law presents problems, the right to the TILA civil liability for nondisclosure rests on federal law. TILA is remedial legislation, designed to prevent predatory creditor practices, and must be liberally construed to effectuate the intent of Congress. See Mourning v. Family Publications Service, Inc., 411 U.S. 356, 365, and Littlefield v. Walt Flanagan and Company, 10 Cir., 498 F.2d 1133, 1136.

Three circuits have held that nondisclosure of the seller's rights to unearned and returned premiums violates TILA and subjects the seller to the statutory liability. See Gennuso v. Commercial Bank & Trust Company, 3 Cir., 566 F.2d 437; Edmondson v. Allen-Russell Ford, Inc., 5 Cir., 577 F.2d 291, cert. denied 441 U.S. 951; and Valencia v. Anderson Brothers Ford, 7 Cir., —— F.2d ——. The last of these, Valencia, was decided on March 20, 1980.

On March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act" as Title VI of the "Monetary Control Act of 1980." P.L. 96-221, 94 Stat. 132. Section 614(a) amends 15 U.S.C. § 1638(a), the disclosure section of TILA. Subsection (a)(9) reads, U.S. Cong. & Adm. News, No. 3, May 1980, 94 Stat. 179:

> "Where the credit is secured, [the creditor shall disclose to the extent applicable] a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

S. R. 96-368, U.S. Cong. & Adm. News, supra, p. 850, states the purpose of the 1980 amendments thus:

> "Despite the act's clear successes, however, there is a growing belief among consumers and creditors alike

that the act could be substantially improved. There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions. There is also evidence that many creditors have sincerely tried to comply with the act but, due to its increasing complexity and frequent changes, have nonetheless found themselves in violation and subject to litigation. In addition, this committee and other congressional and government sources have found the level of administrative enforcement by the Federal bank agencies seriously inadequate. In short, the committee believes that the interests of both consumers and creditors would be furthered by simplification and reform of the act."

With particular reference to the amendment of the disclosure requirements of § 1638(a), the Senate Report says, Id. p. 864:

"The security interest disclosure is also simplified to eliminate the technical disclosure of the type of security interest taken. When a security interest is being taken in property purchased as part of the credit transaction, this section requires a statement that a security interest has been or will be taken in the property purchased. When a security interest is being taken in property not purchased as part of the credit transaction, *the Committee intends this provision to require a listing by item or type of the property securing the transaction, but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums, rights arising

> under, or waived in accord with state law, accessions, accessories or proceeds." (Emphasis supplied)

S. Rep. No. 96-73 says, Id. at 879-880:

> "The subcommittee learned that judging from consumer tests in other areas, the typical disclosure statement utilized today by creditors is not an effective communication device. Most disclosure statements are lengthy, written in legalistic fine print, and have essential truth in lending disclosures scattered among various contactual [sic] terms.
>
> The result is a piece of paper which appears to be 'just another legal document' instead of the simple, concise disclosure form Congress intended."

Ford Motor Credit Co. v. Milhollin, —— U.S. ——, 48 L.W. 4145, decided February 20, 1980, was concerned with the imposition of the statutory liability under TILA for a claimed nondisclosure of an acceleration clause. The Court concluded, 48 L.W. at 4146, that the issue of acceleration disclosure "is not governed by clear expression in the statute or regulation, and * * * it is appropriate to defer to the Federal Reserve Board and staff in determining what resolution of that issue is implied by the truth in lending enactments." The Court examined the Federal Reserve Board staff treatment of acceleration disclosure and denied imposition of the statutory liability.

We are aware of no administrative interpretations pertinent to the particular issue before us. Public Position Letter No. 377, quoted in Edmondson, 577 F.2d 295, n. 8, relates to life insurance, not physical damage insurance. Staff Letter 1263, Consumer Credit Guide (CCH) ¶ 31,736 (November 23, 1977), an unofficial interpretation, leaves to state law the question of whether a security interest has been acquired by the creditor and, if so, whether that interest has been adequately identified.

In Milhollin, supra, 48 L.W. at 4149, the Court said:

> "The concept of 'meaningful disclosure' that animates TILA (citation omitted), cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . informational overload' (citations omitted) and striking the appropriate balance is an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." (Emphasis in original).

The Milhollin approach parallels the intent of Congress in enacting the 1980 amendments and the legislative history of those amendments. The effort is to strengthen the impact of TILA by simple, concise disclosures which can be understood by consumers and creditors. The installment contract in issue identifies the security interest taken in the property purchased, the pick-up truck. The insurance charge is specifically noted on the face of the contract and is included in the total amount which must be repaid in monthly installments. The insurance on damage to the vehicle was part of the credit transaction. The right of the seller to the returned premium would seem to be part of the "proceeds" of that transaction. If not such a part, the returned premium is property not purchased. The Senate Report, supra p. 864, says with reference to property not purchased, that the disclosure need not include "a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums." We are convinced that the Act does not require, and Congress did not intend it to require, an exemplification of that interest on the face of the installment contract. Because of this conclusion, we need not delve into the legal complexities of the Third Circuit decision in Gennuso, 566 F.2d 437; the Fifth

Circuit decision in Edmondson, 577 F.2d 291; and the Seventh Circuit decision in Valencia, —— F.2d ——.

The application of Milhollin and the 1980 actions of Congress present no retroactivity problem. We are concerned only with civil liability for nondisclosure. The buyers have shown no damage. Our decision establishes no new principle of law. Rather, it recognizes the congressional intent. Application to this case furthers the operation of TILA and produces an equitable result. See Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107.

Affirmed.

No. 78-1806—JAMES v. FORD MOTOR CREDIT COMPANY, et al.

DOYLE, Circuit Judge, dissenting.

Because of my belief that the seller's right to unearned and returned premiums is a security interest, and thus the installment purchase contract here violates the Truth in Lending Act, I respectfully dissent.

The question is whether the provision in the contract which provides that the buyer assigns to the seller any monies payable under the insurance (on the car), including returned or unearned premiums, and which authorizes the seller on behalf of both parties to receive or collect same constitutes a violation of the Truth in Lending Act.

Regulation Z, 12 C.F.R. Section 226.2(gg), defines security interest as meaning "any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code. . . ."

This problem is not a new one. Three circuits have considered this issue and have held that the nondisclosure of

the seller's right to unearned and returned premiums violates the Truth in Lending Act and subjects the seller to the remedy which is being pursued here. The cases are Gennuso v. Commercial Bank & Trust Company, 566 F.2d 437 (3rd Cir. 1977); Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951; and Valencia v. Anderson Brothers Ford, —— F.2d —— (7th Cir. March 20, 1980).

The earliest of these decisions is Gennuso v. Commercial Bank & Trust Co., *supra*. Here the plaintiff charged that the Commercial Bank and Trust Company failed to properly identify in the Disclosure Statement and in the Note and Security Agreement a security interest in the proceeds and the unearned premiums in a property insurance policy covering the automobile that he had purchased. It was alleged that such failure violated the Truth in Lending Act and Regulation Z. No mention of the security interest in the insurance policy was made at the top of the note where the collateral was described. There had been some slight mention of the interest in question in the note and security agreement. It was held that the use of general language in this document was sufficient. It was said that the mention of the security interest in after-acquired property satisfied the requirements of the Act. The court held that the conduct of the bank constituted a violation of the Truth in Lending Act and Regulation Z as well.

To the same effect is Edmondson v. Allen-Russell Ford, Inc., *supra*. Here again the court held that the assignment of a returned or unearned premium of an insurance policy was a security interest for purposes of Regulation Z, in accordance with the Truth in Lending Act, and had to be disclosed. The court, through Goldberg, J., had no difficulty concluding that the unearned portion of the premium was a security interest which had to be disclosed. The court relied on Gennuso v. Commercial Bank & Trust Co., *supra*.

Here again the court ruled that it was inadequate to construe the general provision that the " 'Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof. . . .' " 577 F.2d at 295. The court said that the "lender must disclose the type of security interest held, retained, or acquired and the property of the borrower which serves or will serve as the collateral." 577 F.2d at 295. A sufficient description was determined to be essential.

The third of the recent circuit cases is Valencia v. Anderson Brothers Ford, *supra,* from the Seventh Circuit. The court said:

> We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue. In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

Slip op. at p. 14.

The majority was influenced by the fact that on March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act," which amended 15 U.S.C. Section 1638(a), the disclosure section of the Truth in Lending Act. As amended, it was pointed out by the majority that this section permits disclosure of the principal property which provides the security for the loan. It does not require, so the Report says, a listing of related or incidental interests in the property, and it gives as an example a loan secured by an automobile which is not being purchased with the proceeds of the loan, but which would require a state-

ment indicating that the loan is secured by an automobile. It would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums.

The majority also calls attention to the recent opinion of the Supreme Court in Ford Motor Credit Co. v. Milhollin, ____ U.S. ____, 48 L.W. 4145, decided February 20, 1980, which adopted the approach that security documents have, in the past, carried too much excess luggage and that they should disclose with simplicity and should limit themselves to the disclosure of the matters having to do with the security itself. This may well be the present tendency, but at the time of the occurrence in question the approach which is shown by the Third, Fifth and Seventh Circuits obtained.

In summary, the automobile insurance policy and, of course, the premium which is paid to obtain the coverage, are part and parcel of the entire automobile financing business. It makes the loan more secure.[1] Thus the unearned premium which would ordinarily go to the insured and which is being held back by the lender is information of genuine interest to the purchaser-insured, and it is not possible to cause it to be unimportant.

The new approach might render the procedure less complicated. Nevertheless, I submit that we are not justified in adopting this concept so as to apply it to the present set of facts and to do so only on the basis of legislative history which attended the enactment of the amendments. Even if the legislative history would call for a different result, it should not be applied here in a retroactive way.

For the reasons stated, I disagree with the majority opinion.

---

[1] If, for example, the automobile were to be stolen or totaled out in an accident, there would be no security in the absence of insurance.

ACCOUNT NO. _____

ILLINOIS AUTOMOBILE RETAIL INSTALLMENT CONTRACT Dr

Buyer (and Co-Buyer) - Name and Address (Include - County and Zip Code)

OLGA A. VALENCIA + MIGUEL GONZALES
2431 S. RIDGEWAY
CHGO, IL 60623

Seller - Name and Address

Anderson Bros Ford
6539 Ogden Ave.
Berwyn, IL 60402

Buyer (which means the undersigned Buyers and Co-buyers, jointly and severally) having been quoted both a deferred payment price and a lesser cash price hereby purchases from Seller on a deferred payment price basis, upon the terms and conditions set forth on the face and reverse sides hereof, the following property (hereinafter called the "Property") delivery and acceptance of which in good order hereby are acknowledged by Buyer.

New or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Manufacturer's Serial Number	Use For Which Purchased
U	74 FORD	PINTO	2dr.	4		4X10Y785345	☒ Personal ☐ Agriculture ☐ Business

INCLUDING: ☒ Radio ☐ Air Conditioner ☒ Automatic Transmission ☐ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☒ Service Contract

DESCRIPTION OF TRADE IN

_____ (Year and Make)

$ _____ (Gross Allowance)

$ — (Amount Owing)

OPTIONAL INSURANCE

Buyer authorizes Seller to obtain the following insurance coverages:

(a) **Physical Damage Insurance:** Coverages checked below for a term of _____ months (or for such shorter term as the insurer to whom Seller shall apply therefor will provide for the amount included herein) from the date hereof, payable to Buyer or Seller as interests may appear:

☐ Comprehensive ☐ Fire-Theft & Combined Additional Coverage

☐ $_____ Deductible Collision ☐ Towing & Labor Costs ($25.00 Limit)

$ _____ (a)

(b) **Credit Life Insurance** on the life of _____ (Insured Person) for the term of this Contract.

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date.

$ — (b)

(c) **Credit Accident and Health or Disability Insurance** provided by

DETAILS OF TRANSACTION

(1) Cash Price		$3412.00 (1)
Cash Down Payment	$1,000.00	
Trade In (See Opposite)	$ —	
(2) Total Down Payment		$1,000.00 (2)
(3) Unpaid Balance of Cash Price (Difference between Items 1 & 2)		$2412.00 (3)
(4) Other Charges	Service Contract	$ —
Optional Insurance (See Opposite)	$	
Official Fees	$	
Taxes (Not included in Cash Price)	$	
License, Title & Registration Fees	$	
Total Other Charges		$ — (4)
(5) Unpaid Balance - Amount Financed		$2412.00 (5)
(6) FINANCE CHARGE		$ 319.20 (6)
(7) ANNUAL PERCENTAGE RATE	21.44 %	(7)
(8) Total of Payments (Sum of Items 5 & 6)		$2731.20 (8)

(9) Payment Schedule: Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 9.12 each and one final instalment of $ 9.24 on the like day of each month commencing Nov 2 19 77, or, if no date is specified, one month after the date of this contract.

☐ $_____ Deductible ☐ Collision ☐ Towing & Labor Costs ($25.00 Limit) /

(b) Credit Life Insurance on the life of _____ for the term of this Contract. (Insured Person)

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date. $_____ (b)

(c) Credit Accident and Health or Disability Insurance provided by _____ for the term of this Contract in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date..... $_____ (c)

(d) Other Optional Insurance _____ (Itemize) $_____ (d)

Total Cost of Optional Insurance..... $_____

NOTICE TO BUYER: (1) You are not required to obtain the Credit Life and/or Credit Accident and Health or Disability Insurance for which a charge is indicated above and such is not a factor in the Seller's approval of this credit. Such insurance may be cancelled from its inception within 15 days from the date hereof by written request from each Buyer and any Guarantor. Upon cancellation, the entire charge therefor shall be refunded or credited to Buyer. (2) You have the right to choose the person through whom the Physical Damage Insurance required under this contract is to be obtained. **ACKNOWLEDGING** the foregoing, **BUYER** requests and authorizes **SELLER** to obtain each insurance coverage for which an amount is included above.

Buyer _____ Date _____

_____ Date _____

(Cost Of Insurance To Be Included Only If Signed By Each Insured Buyer And Dated).

LIABILITY INSURANCE COVERAGE FOR BODILY INJURY AND PROPERTY DAMAGE CAUSED TO OTHERS IS NOT INCLUDED.

CREDIT LIFE INSURANCE ELIGIBILITY

Credit life insurance under Ford Life Insurance Company's Group Policy No. 2200 is available only on the life of one natural person who is obligated to make payments under this retail instalment instrument and who is under the age of 66 on the date hereof. Benefits will be limited to a refund of premiums if there is no person eligible for such insurance, or if death results from suicide within one year from the date hereof or from certain pre-existing diseases or conditions within ninety days from the date hereof. For details see Notice of Proposed Group Credit Life Insurance on reverse side of Buyer's Copy.

The foregoing contract hereby is accepted by the Seller and assigned to *Ford Motor Credit Company* in accordance with the terms of the Assignment set forth on the reverse side hereof.

Seller _____

By _____ Title _____

Total Other Charges	$	(4)
(5) Unpaid Balance – Amount Financed	$ 1340.62	(5)
(6) FINANCE CHARGE	$ 319.22	(6)
(7) ANNUAL PERCENTAGE RATE	21¼ %	(7)
(8) Total of Payments (Sum of Items 5 & 6)	1659.84	(8)

(9) Payment Schedule: Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 69.12 each and one final instalment of $ 69.12 on the like day of each month commencing Nov 2 19 77, or, if no date is specified, one month after the date of this contract.

(10) Deferred Payment Price (Sum of Items 1, 4 & 6) $ 2659.84 (10)

(11) Delinquency Charges: Buyer hereby agrees to pay a delinquency charge on each instalment in default for more than 10 days in the amount of 5% thereof or $5.00, whichever is less, plus such expenses incurred by Seller in effecting collection hereunder as may be allowed by law.

(12) Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

(13) Prepayment Rebate: Buyer may prepay his obligations under this contract in full at any time prior to maturity of the final instalment hereunder, and, if he does so, shall receive a rebate of the unearned portion of the Finance Charge computed under the sum of the digits method after first deducting an acquisition fee of $25.00. No rebate will be made if the amount thereof is less than $1.00.

(14) Additional Terms and Conditions: The additional terms and conditions set forth on the reverse side hereof are a part of this contract and are incorporated herein by reference.

NOTICE TO THE BUYER

1. **Do not sign this agreement before you read it or if it contains any blank spaces.**
2. **You are entitled to an exact copy of the agreement you sign.**
3. **Under the law you have the right, among others, to pay in advance the full amount due and to obtain under certain conditions a partial refund of the finance charge.**

Buyer acknowledges receipt of a true and completely filled in copy of this contract at time of signing.

RETAIL INSTALLMENT CONTRACT

Buyer Signs _____

Co-Buyer Signs Miguel Gonzalez

Guarantor Signs _____

I hereby guarantee the collection of the above described amount upon failure of the seller named herein to collect said amount from the buyer named herein.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

ADDITIONAL TERMS AND CONDITIONS

15. ASSIGNMENT

The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

16. USE OF PROPERTY – WARRANTIES

Buyer shall keep the Property free from all encumbrances, and any amount that may be paid by Seller in release or discharge thereof shall be paid by Buyer to Seller forthwith upon demand with interest at the highest lawful contract rate. Buyer shall not use the Property illegally, improperly or for hire (unless stated herein) and shall not remove the Property from the county of his residence without the written permission of Seller. **No representation, promise or warranty, express or implied, has been made with respect to the merchantability, suitability or fitness for purpose of the Property or otherwise unless the same is endorsed hereon in writing or is contained in a separate written instrument signed by the original Seller.**

RISK OF LOSS – INSURANCE

The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require. The inclusion of a charge for insurance herein shall not relieve Buyer of such obligation but only authorizes Seller to attempt to obtain the requested coverages on Buyer's behalf through an authorized agent; provided, if Seller is unable to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

18. DEFAULT

Time is of the essence of this contract. In the event Buyer defaults in any payment, or fails to obtain or maintain the insurance required hereunder, or fails to comply with any other provision hereof, or a proceeding in bankruptcy, receivership or insolvency shall be instituted by or against Buyer or his property, or Seller deems the Property in danger of misuse or confiscation, or Seller otherwise reasonably deems the indebtedness or the Property insecure, Seller shall have the right to declare all amounts due or to become due hereunder to be immediately due and payable and Seller shall have all the rights and remedies of a Secured Party under the Uniform Commercial Code, including the right to repossess the Property wherever the same may be found with free right of entry, and to recondition and sell the same at public or private sale. Upon request, Buyer shall deliver the Property to Seller at a place designated by Seller. Seller shall have the right to retain all payments made prior to repossession and Buyer shall remain liable for any deficiency. Any personalty in or attached to the Property when repossessed may be held by Seller without liability and Buyer shall be deemed to have waived any claim thereto unless written demand by certified mail is made upon Seller within 24 hours after repossession. Buyer agrees to pay reasonable attorneys' fees (15% if permitted by law) and other expenses incurred by Seller in effecting collection, repossession or resale hereunder. Seller's remedies hereunder are in addition to any given by law and may be enforced successively or concurrently. Waiver by Seller of any default shall not be deemed a waiver of any other default.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder together with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor _____ Address _____

Guarantor _____ Address _____

tain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require. The inclusion of a charge for insurance herein shall not relieve Buyer of such obligation but only authorizes Seller to attempt to obtain the requested coverages on Buyer's behalf through an authorized agent; provided, if Seller is unable to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

unless written demand by certified mail is made upon Seller within 24 hours after repossession. Buyer agrees to pay reasonable attorneys' fees (15% if permitted by law) and other expenses incurred by Seller in effecting collection, repossession or resale hereunder. Seller's remedies hereunder are in addition to any given by law and may be enforced successively or concurrently. Waiver by Seller of any default shall not be deemed a waiver of any other default.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder togetner with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor_____ Address_____

Guarantor_____ Address_____

FORD LIFE INSURANCE COMPANY
NOTICE OF PROPOSED GROUP CREDIT LIFE INSURANCE

Notice hereby is given that if a charge for group credit life insurance to be provided by Ford Life Insurance Company, Dearborn, Michigan, under its Group Policy No. 2200 is separately stated as a part of the balance payable under the annexed retail instalment instrument, and if such instrument is assigned or otherwise transferred to Ford Motor Credit Company, the group policyholder, and if the person to be insured is eligible for such insurance as hereinafter provided, life insurance protection under the said Group Policy will be provided upon the life of such person with respect to such instrument. Any natural person is eligible for such insurance if he is primarily or secondarily obligated to make the payments provided in such instrument and has not attained his 66th birthday on or before the effective date of such instrument. The Insured Person will be the person named as such in such instrument if such person is eligible for insurance hereunder. In the event no person is named as the Insured Person, or if the person so named is not eligible for such insurance, then the Insured Person will be: (a) if the Buyer named in such instrument is one or more natural persons, that natural person whose signature as "Buyer" appears first; (b) if the Buyer named therein is a partnership, that natural person, being a partner, whose signature on behalf of the partnership appears first; or (c) if any Buyer named therein is a corporation, that natural person who is personally obligated on the instrument and whose signature as "Buyer" or "Co-Buyer" appears first; provided that in the event there is no natural person obligated under such instrument under the age of 66 as of the effective date thereof, all provisions with respect to such credit life insurance will be void and of no effect. Such insurance will become effective from the date the obligation of the Buyer named in such instrument is incurred and will, in the absence of default in any payment coming due thereunder, remain in force, subject to the terms of the Group Policy, until discharge of all obligations thereunder. Any amount becoming payable at the death of the Insured Person will be applied to reduce or extinguish Buyer's obligation thereunder. The amount of insurance will be the amount owing from time to time under such instrument but not to exceed $10,000 less the amount of existing insurance on the date of such instrument with respect to any other obligation for which the Buyer is insured under the said Group Policy; provided that the amount payable under the said Group Policy will be limited to a credit or refund of the amount included as the premium or cost of such insurance in such instrument in the event that death of the Insured Person results from (a) suicide, while sane or insane, within one year from the effective date of the insurance, or (b) a disease, injury or health condition for which the Insured Person was hospitalized or received medical treatment within the thirty days immediately preceding the effective date of the insurance, if death occurs within the ninety days immediately following such date. If the insurance becomes effective, a certificate of insurance describing the coverage afforded in greater detail will be furnished to the Buyer within thirty days. If the insurance is declined by the insurer or otherwise does not become effective or if a charge for an amount of insurance in excess of the foregoing limit is made, notice thereof will be sent to the Buyer and the appropriate portion of the charge for such insurance together with the finance charge applicable thereto promptly will be credited or refunded to the Buyer. In the event such insurance terminates during the lifetime of the Insured Person, the portion of the insurance charge applicable to the period subsequent to the date of termination will be refunded or credited to the Buyer. No refund or credit of insurance charge will be made if the amount thereof is less than $1.00. The insurance charge refund formula is on file with the state official having supervision of the proposed insurance and a copy thereof is on file with the group policyholder.
FL13025

THE ABOVE NOTICE APPLIES ONLY IF A CHARGE FOR CREDIT LIFE INSURANCE UNDER FORD LIFE INSURANCE COMPANY'S GROUP POLICY NO. 2200 HAS BEEN STATED IN THE ANNEXED INSTRUMENT. IF A CHARGE FOR OTHER CREDIT LIFE INSURANCE OR OTHER INSURANCE HAS BEEN INCLUDED THEREIN, BUYER WILL BE FURNISHED WITH SUCH APPLICATION, NOTICE, CERTIFICATE OR POLICY WITH RESPECT THERETO AS IS REQUIRED BY LAW.

FMCC 11712 May 76

Deft Dep. Ex. No. 10 Id.
Date: 2/2/79
Reporter: D.C.

Supreme Court, U. S.
FILED
JAN 6 198
MICHAEL RODAK, JR., CLERK

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED JULY 19, 1980.
CERTIORARI GRANTED NOVEMBER 10, 1980.

TABLE OF CONTENTS

	PAGE
Chronological List of Relevant Docket Entries	1
Complaint, filed May 3, 1978	2
Ford Motor Credit Company's Motion to Dismiss Complaint, filed June 9, 1978	7
District Court's Decision granting Motion to Dismiss Complaint, entered on October 31, 1978	9
District Court's Supplemental Decision vacating the Decision of October 31, 1978 in part, entered on November 17, 1978	19
Answer and Defenses of Ford Motor Credit Company to Complaint, filed December 8, 1978	22
Plaintiffs' Motion for Summary Judgment, filed February 5, 1979	30
Defendants' Cross-Motion for Summary Judgment, filed February 26, 1979	31
District Court's Decision granting Plaintiffs' Motion for Summary Judgment, entered on June 5, 1979....	33
Judgment Entered by District Court in favor of Plaintiffs on June 15, 1979	36
Opinion and Order of Court of Appeals affirming District Court's Judgment, entered on March 20, 1980..	38
Order of Court of Appeals denying Petition for Rehearing, entered on April 22, 1980	66
Illinois Automobile Retail Installment Contract dated September 30, 1977 [following 66]	

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

May 3, 1978	Complaint filed
June 9, 1978	Ford Motor Credit Company's Motion to Dismiss Complaint filed
October 31, 1978	District Court's Decision granting Motion to Dismiss Complaint
November 17, 1978	District Court's Supplemental Decision vacating the Decision of October 31, 1978 in part
December 8, 1978	Answer and Defenses of Ford Motor Credit Company to Complaint filed
February 5, 1979	Plaintiffs' Motion for Summary Judgment filed
February 26, 1979	Defendants' Cross-Motion for Summary Judgment filed
June 5, 1979	District Court's Decision granting Plaintiffs' Motion for Summary Judgment
June 15, 1979	Judgment Entered by District Court in favor of Plaintiffs
June 25, 1979	Motion of Defendants to Reconsider and Vacate, or in the Alternative, to Alter or Amend, the Judgment Entered in Favor of Plaintiffs on June 15, 1979 filed
July 2, 1979	District Court's Order modifying Judgment entered on June 15, 1979
July 31, 1979	Defendants' Notice of Appeal filed
March 20, 1980	Opinion and Order of Court of Appeals affirming District Court's Judgment
April 3, 1980	Defendants-Appellants' Petition for Rehearing and Suggestion for Rehearing in Banc filed
April 22, 1980	Order of Court of Appeals denying Petition for Rehearing

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA and MIGUEL GONZALEZ,

Plaintiffs,

vs.

ANDERSON BROS. FORD, and FORD MOTOR CREDIT COMPANY,

Defendants.

COMPLAINT

Now come the plaintiffs, Olga Valencia and Miguel Gonzalez, by their attorneys and complain against the defendants, Anderson Bros. Ford ("Anderson") and Ford Motor Credit Company ("Ford") as follows:

COUNT I

1. This is an action for statutory damages, attorneys' fees and costs based on the defendants' violations of the Truth-in-Lending Act, 15 U.S.C. § 1601 *et seq.*, ("TIL") and Regulation Z, 12 C.F.R. § 226 *et seq.*

2. This Court has jurisdiction over this case pursuant to TIL, § 1460(e) [sic].

3. The plaintiffs Olga Valencia and Miguel Gonzalez are residents of Chicago, Illinois.

4. Defendant Anderson is an Illinois corporation with its principal place of business in Berwyn, Illinois. Anderson is engaged in the business of selling automobiles to the general public on a retail installment basis.

5. Defendant Ford is a foreign corporation doing business in the state of Illinois. Ford is engaged in the business of financing automobile retail installment contracts.

6. At all times relevant hereto, Anderson and Ford were "creditors" as defined in TIL, § 1602(f) and Z, § 226.2(m), which in the ordinary course of business extend, or arrange for the extension of credit to natural persons for their personal, family or household use.

7. On or about September 30, 1977, plaintiffs entered into a retail installment contract with Anderson for the purchase of a used 1974 Ford Pinto, serial No. 4X10Y285345, for their personal, family and household use. A copy of the contract is attached hereto as Exhibit A and made a part hereof.

8. A clause of the contract provides that all claims and defenses may be equally asserted against Anderson and Ford.

9. Anderson subsequently assigned the contract to Ford.

10. The contract discloses that the amount financed is $1,340.00, the finance charge is $319.84 and the total of payments is $1,659.84, which is to be paid in 24 installments of $69.16 each.

11. The defendants have violated TIL and Regulation Z in the course of this transaction in the following respects:

(a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of Regulation Z §§ 226.8(b)(5) and 226.8(a).

(b) By failing to disclose a retained security interest in insurance proceeds in violation of Regulation Z §§ 226.8(b)(5) and 226.8(a).

(c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a par-

tial refund of the unearned finance charge in violation of Regulation Z § 226.8(b)(6) and (7).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of 15 U.S.C. § 1638(a)(9) and Regulation Z § 226.8(b)(4).

(e) By failing to properly disclose Ford as a creditor in this transaction in violation of Regulation Z § 226.6(d).

WHEREFORE, Plaintiffs pray:

A. That this court enter a judgment for Olga Valencia in the amount of $639.68 statutory damages.

B. That this court enter a judgment for Miguel Gonzalez in the amount of $639.68 statutory damages.

C. That this court grant plaintiffs a judgment for attorneys' fees and costs.

D. That the Court grant such other relief as it deems just and proper.

COUNT II

1. This Count is an action against the defendants under the Illinois Motor Vehicle Retail Installment Sales Act, Ill.Rev.Stat., ch. 121½, §§ 561 *et seq.*, (MVRISA).

2. This court has pendent jurisdiction to adjudicate the claims set forth in this Count because the federal an [sic] state claims set forth in Counts I and II derive from a common nucleus of operative facts and are such that a plaintiff would ordinarily be expected to try them both in one judicial proceeding.

3.-10. Plaintiffs reallege ¶¶s 3-10 of Count I as ¶¶s 3-10 of this Count II.

11. At all times relevant hereto, plaintiffs were buyers as defined in MVRISA, § 562.2. Anderson was a seller as defined in the MVRISA, § 562.3. Ford was a sales finance agency and a holder as defined in the MVRISA, §§ 562.11 and 562.12, and the transaction was a retail installment transaction as defined in the MVRISA, § 562.4.

12. Defendants have violated the MVRISA in the following respects

(a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of MVRISA, § 565(13).

(b) By failing to disclose a retained security interest in insurance proceeds in violation of MRISA, § 565(13) [sic].

(c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of §§ 565(4) and (12).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of § 565(14) and (15).

13. For the foregoing violations, § 584(b) of the MVRISA provides that the defendants may collect no finance charge, delinquency, or collection charge in connection with the retail installment contracts of the plaintiffs.

WHEREFORE, Plaintiffs pray:

A. That the court enter a judgment declaring that defendants have violated the MVRISA, in the transaction of the plaintiffs, and may, therefore, not collect any finance charges, delinquency or collection charges in connection with that transaction.

B. That the court enjoin defendants from collecting any finance charges, delinquency or collection charges in connection with the transaction of the plaintiffs and order the return of any such charges already collected.

C. That the Court grant such other relief as it deems just and proper.

/s/ Armando Almazan
One of the Attorneys for Plaintiffs

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROS. FORD,

Defendant,

AND FORD MOTOR CREDIT COMPANY,

Defendant and Counterplaintiff.

MOTION TO DISMISS

Defendant and counterplaintiff Ford Motor Credit Company ("Ford Credit"), by its attorneys, hereby moves the Court pursuant to Rule 12(b) of the Federal Rules of Civil Procedure for an order dismissing with prejudice the Complaint filed by Olga Valencia and Miguel Gonzalez, plaintiffs and counterdefendants (the "plaintiffs"). In support of this motion Ford Credit states as follows:

COUNT I

1. Count I of the Complaint is based on alleged violations of the Consumer Credit Protection Act (the "Truth-in-Lending Act"), 15 U.S.C. § 1601 *et seq.*, in connection with the Illinois Automobile Retail Installment Contract executed by plaintiffs on September 30, 1977 (the "Contract"). However, Count I of the Complaint fails to state a claim upon which relief can be granted because the Contract on its face fully complies with all of the disclosure requirements of the Truth-in-Lending Act.

COUNT II

2. Count II of the Complaint is based on alleged violations of the Illinois Motor Vehicle Retail Installment Sales Act ("MVRISA"), Ill. Rev. Stat. ch. 121½ § 561 *et seq.*, in connection with the Contract. Since, as discussed above, the Complaint fails to state a claim upon which relief can be granted under the Truth-in-Lending Act, the Court lacks jurisdiction over the claim alleged under state law in Count II.

3. Count II of the Complaint fails to state a claim upon which relief can be granted because the Contract on its face fully complies with all of the disclosure requirements of MVRISA.

WHEREFORE, Ford Credit moves that Counts I and II of the Complaint be dismissed with prejudice.

Aaron J. Kramer
Carl A. Royal
Richard R. Ertel

By /s/ Richard R. Ertel
Attorneys for Ford Motor Credit Company

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(Certificate of Service Omitted in Printing)

DECISION OF THE DISTRICT COURT

OCTOBER 31, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

Defendant Ford Motor Credit Co. filed a motion to dismiss the complaint in the above-entitled cause on June 9, 1978, subsequently supported by an affidavit of its Collections Supervisor dated June 15, 1978. The affidavit incorporates a true copy of the Automobile Retail Installment Contract upon which the complaint is based, and contains a statement of this defendant's policy and practice under paragraph 18 of the Contract, thus converting the motion to dismiss into one for summary judgment with respect to the matters contained in the affidavit. We find and conclude that no genuine issues of material fact are presented by the pleadings and that this defendant's motion to dismiss the complaint should be granted as a matter of law.

The complaint is typical of many filed pursuant to the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.* and Regulation Z thereunder, 12 C.F.R. ¶ 226 *et seq.*, adding a pendent claim pursuant to the Illinois Motor Vehicle Retail Installment Sales Act, Ch. 121½ § 561 *et seq.* of the *Ill. Rev. Stat.* (1977). Plaintiffs sue for $639.68 statutory damages together with attorney's fees and costs, and also seek an

injunction restraining the collection of any finance charges, delinquency or collection charges, past, present or future, pursuant to the Illinois statute. Defendant counterclaims for the amount overdue on the contract.

We will deal with the five specific violations of the Truth in Lending Act alleged in par. 11 of the Complaint, and in doing so will dispose of the equivalent violations alleged under the Illinois statute. Defendant is alleged to have violated the Acts:

> (a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of Regulation Z § 226.8(b)(5) and 226.8(a).

Regulation 226.8(b)(5) requires specific disclosures to include:

> A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, . . .

The security interest complained of, according to plaintiffs' supporting memorandum, is described in § 17 contained on the reverse side of the Contract:

> RISK OF LOSS-INSURANCE
>
> • • •
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

If the foregoing § 17 of the Contract constitutes a "security interest" within the meaning of Regulation 226.8(b)(5), then pursuant to Regulation 226.8(a) it is an "obligation" which must be disclosed on the face of the contract above the customer's signature or on a separate statement which identifies the transaction. The better view, in our opinion, is that the assignment of proceeds of unearned premiums in § 17 of the Contract is not a security interest when viewed in the context of the contract or in the purchase and sale of automobiles. It is not similar to a chatel mortgage. It is not a lien on the automobile which must be disclosed on the certificate of title, need not be released in order to transfer clear title to the automobile, and can be used, according to § 17, either toward replacement of the automobile or payment of the purchaser's indebtedness.

It is instructive to note that a security interest is defined in § 12 of the Contract, above the purchaser's signature, as follows:

> Seller shall have a security interest under the Uniform Commercial Code in the Property [an automobile] and in the proceeds *thereof* to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder. [emphasis added]

This grants a security interest in the property itself and in its proceeds, in the event of a creditor's sale, and is the customary type of security interest retained on an installment contract for the purchase of an automobile. The assignment of unearned insurance premiums is not a security interest in the normal meaning of that term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents.

We also note a provision in § 570 of the Illinois statute, which must be read *in pari materia* with the Federal statute, as follows:

> If any required insurance for which an amount is included in the contract is cancelled, any unearned insurance refund . . . shall be credited on the final maturing installments of the contract except to the extent those amounts are applied toward payment for similar insurance protecting the interests of the buyer and the holder or either of them. . . .

In the case at bar, no insurance premiums were "included in the contract," hence the foregoing § 570 is not strictly applicable. Nevertheless, it helps us construe the contract in the light of Illinois law, where it is to be performed, and makes it rather clear that unearned insurance premiums do not constitute a security interest in the automobile. As with many other provisions, it provides an added protection to secure performance of the buyer's financial obligation under the contract, but below the level of a "security interest." See also *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. Dec. 16, 1976).

> (b) By failing to disclose a retained security interest in insurance proceeds in violation of Reg. Z, §§226.8(b)(5) and 226.8(a).

This retention is disclosed in § 12 on the face of the contract, quoted above, p. 4. For this reason, and for the reason that plaintiffs have not pointed out any reason why the assignment of insurance proceeds is any different, as a matter of law, than the assignment of unearned insurance premiums, defendant Ford is entitled to dismissal of this allegation of par. 11 of the Complaint.

> (c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for

a partial refund of the unearned finance charge in violation of Regulation Z § 226.8(b)(6) and (7).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of 15 U.S.C. § 1638(a)(9) and Regulation Z § 226.8(b)(4).

In these subparagraphs, plaintiffs complain about the provisions of § 18 of the Contract, contained on the reverse side from the signature page. This section provides for acceleration, upon default, of all amounts due or to become due, and incorporates all remedies available under the Uniform Commercial Code. It does not specify how unearned finance charges will be computed and whether or not they will be credited to the buyer. In this respect, plaintiffs rely upon 15 U.S.C. § 1638(a)(9) and 12 C.F.R. § 226.8(b)(4). Both of these require disclosure of "default, delinquency, or similar charges." In addition, 12 C.F.R. § 226.8(b)(6) and (7) apply to "penalty charges" and the computation of unearned finance charges upon *voluntary* prepayment of the principal. Defendant's contract computes only the latter.

The short answer to this contention is that an acceleration clause does not constitute a "charge" if the unearned interest is not retained by the seller. The overwhelming weight of authority is contrary to the plaintiffs' contentions. *Griffith* v. *Superior Ford,* 577 F.2d 455 (8th Cir. 1978); see also *McDaniel* v. *Fulton National Bank of Atlanta,* 571 F.2d 948, 950 (5th Cir. 1978) (en banc). The *Griffith* court rejects, as we do, the rather artificial approach taken by the Ninth Circuit in *St. Germain* v. *Bank of Hawaii,* 573 F.2d 572, 576 (9th Cir. 1977), to the effect that acceleration is equivalent to voluntary full prepayment and that, in the latter instance, the method of computing *any* un-

earned portion of the finance charge must be disclosed in the contract.

The Federal Reserve Board Staff's interpretation, issued on July 6, 1977 before the contract in the case at bar was executed, states in pertinent part:

> The fact that the contract is silent concerning rebate upon prepayment after acceleration is not determinative of the issue; the question is whether in fact the creditor does or does not rebate upon prepayment after acceleration in accordance with the rebate method shown on the disclosure statement. In this sense, then, the individual creditor's policy determines whether there is violation of the act and regulation.
> CCH *Consumer Credit Guide* ¶ 31,647 (July 6, 1977)

In the case at bar, the seller does not retain unearned interest upon prepayment in full, according to § 13 on the signature page of the Contract. This practice is not limited to voluntary prepayment under § 13 but also applies to payment of the full balance in the case of default, according to par. 2 of the defendant's affidavit. The affiant specifically states that, upon acceleration in the case of default, "it is the policy and practice of Ford Credit to collect from the debtors that portion of the finance charge which represents the period of time from the date the Contract was executed until the date that the balance owing on the Contract was paid." Paragraph 3 of the affidavit adds that, when the full balance is paid, the unearned portion of the finance charge is rebated to the debtor.

We give great weight to administrative interpretations which have the effect, after due consideration, of modifying previous positions taken by the administrative body. It was the letter of July 6, 1977, quoted above, upon which the Eighth Circuit relied in *Griffith* v. *Superior Ford,* supra p. 7, thereby disagreeing with the Fifth Circuit's decision

which had relied upon an earlier interpretation. *McDaniel* v. *Fulton National Bank of Atlanta,* supra, p. 7. Defendant's affidavit conforms to the Federal Reserve Board Staff letter of July 6, 1977 and is not controverted by any affidavit of the plaintiffs. There is no genuine issue of material fact on this issue and defendant is entitled to summary judgment on pars. 11(c) and (d) of the Complaint.

> (e) By failing to properly disclose Ford as a creditor in this transaction in violation of Regulation Z § 226.6(d).

The reference to Ford is alleged to mean the defendant Ford Motor Credit Co. The complaint here is based upon the following provision in Reg. 226.6(d):

> If there is more than one creditor or lessor in a transaction, each creditor or lessor shall be clearly identified....

The defendant Ford Motor Credit Co. is identified by name as the assignee of the contract on page 1, over the seller's signature. It is also identified by name in the executed Assignment on the reverse side of the contract. Section 15 on the reverse side of the Contract provides further:

> ASSIGNMENT
>
> The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

No provision of the statute or regulation requires that the terms of an assignment be set forth on the signature page, or that the creditor be identified there. Cf. Reg. 226.8(b)(4), (6) and (7). The only question therefore is whether or not defendant Ford Motor Credit Co. is "clearly identified" in the contract. We find and conclude that it is, since the two clauses referred to above must be read together.

It is difficult to understand what additional identification plaintiffs seek, since the defendant assignee replaces the seller in all respects and becomes *the* creditor at the outset. The better authorities, in our opinion, have approved the identification contained in this contract. *Antonio* v. *Canal Motors, Inc.*, No. 74-3163 (E.D. La. Nov. 17, 1977); *Sharp* v. *Ford Motor Credit Co.*, No. 77-1098 (S.D. Ill. June 8, 1978). The foregoing cases, although apparently not published in any reporter, are not disputed by the plaintiffs, and we take judicial notice of them. These and the other decisions cited herein without reporter references are attached to the defendant's reply memorandum filed July 27, 1978.

Pendent Count II. As mentioned above, Count II is filed under the Illinois Motor Vehicle Retail Installment Sales Act, the pertinent subsections of which are indistinguishable from the Truth in Lending Act and its accompanying regulations. In fact, the State of Illinois has patterned its regulations on Regulation Z for the interpretation of its statute. See *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 883-84 (7th Cir. 1976). If Count I fails to state a claim upon which relief can be granted against Ford Motor Credit Co., Count II must be dismissed for the same reason.

Conclusion. Defendant Ford Motor Credit Co. has filed a counterclaim against the plaintiffs to collect payments allegedly due under the installment contract. This is not a compulsory counterclaim under F.R.C.P. 13(a). Since we

will dismiss the complaint against this defendant, we will dismiss its State court cause of action against the plaintiffs also. *Rivera* v. *McGee,* 77 C 1168 and *Roman* v. *Z-Frank, Inc.,* 76 C 1065 (N.D. Ill. 1978).

Defendant Anderson Brothers Ford has filed a crossclaim against Ford Motor Credit Co. on the theory of an implied contract of indemnity. Defendant Ford Motor Credit Co. has filed a motion to dismiss the crossclaim. This motion has not been briefed, and Anderson Brothers Ford is still a defendant to the complaint. However, in view of our decision dismissing the complaint as to the Ford Motor Credit Co., and in view of the fact that exactly the same violations are charged against Anderson as we have ruled to be ineffective against Ford Motor Credit Co., we see no purpose in maintaining the complaint any longer against Anderson Brothers Ford. If the complaint is dismissed against both defendants, then the crossclaim of Anderson against Ford Motor Credit Co. likewise falls.

The Truth in Lending Act as applied to automobile purchases has spawned more litigation and taken more time of the attorneys and the court over relatively minor controversies than any other truth-in-lending action which we have encountered. Some of the plaintiffs have had the fortitude and financial ability to appeal these cases as far as the Courts of Appeals, with varying results. Most of the cases, however, do not proceed to that stage, and none which have been decided by the Seventh Circuit Court of Appeals involve the details and issues raised herein. The plaintiffs in this case are represented by the Legal Assistance Foundation of Chicago which is supported by public funds. Unless a more representative case is already available for the appeal process in this Circuit, we suggest that the case at bar be used as a test to lay at rest some of the troublesome problems raised by this complaint, concerning which there are a multitude of conflicting court decisions.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the motion of the defendant Ford Motor Credit Co. to dismiss the complaint pursuant to F.R.C.P. 12(b) is granted, the complaint against defendant Anderson Brothers Ford is dismissed *sua sponte*, the counterclaim of Ford Motor Credit Co. against the plaintiffs is dismissed, without prejudice, for failure of federal jurisdiction, and the crossclaim of Anderson Brothers Ford against the defendant Ford Motor Credit Co. is dismissed as moot. A rule 58 judgment will enter.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: Oct. 31, 1978

DECISION OF THE DISTRICT COURT
NOVEMBER 17, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

SUPPLEMENTAL DECISION

We have reviewed the discussion and conclusions under section (a) of our decision dated October 31, 1978 and have decided that they are erroneous. This review was instigated by a letter dated November 6, 1978 from counsel for defendant Ford Motor Credit Co. calling our attention to the recent decision in *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978) which also adopts the more definitive decision of *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978).

The *Shanks* decision reversed the unpublished decision which we had cited on page 5 of our decision of October 31, 1978. The *Edmondson* decision relies heavily on *Elzea* v. *National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978) which in effect supersedes *Mims* v. *Dixie Finance Corp.*, 426 F. Supp. 627 (N.D. Ga. 1976) on the definition of a security interest. On this point Judge Morgan relied heavily on *Mims* in *Rounds v. Community National Bank in Monmouth*, 454 F.Supp. 883 (S.D. Ill. 1978)

We are satisfied that the *Edmondson* and *Elzea* decisions are correct in holding that the assignment of unearned insurance premiums *is* a security interest under § 1638(a)(10) of the Truth in Lending Act. We are also satisfied that this security interest was not properly disclosed by defendants in accordance with ¶ 226.8(b)(5) of Regulation Z. We will not burden the parties with additional discussion of the reasons for this change other than to refer them to Judge Goldberg's persuasive and perceptive analysis in *Edmondson*.

Although the court in *Edmondson* and *Shanks* does not reach the similar issue regarding insurance proceeds, the rationale of these decisions also applies to the security interest discussed in par. (b) of our decision of October 31, 1978. However, it remains our opinion that this security interest is properly disclosed in Section 12 of the contract, quoted on page 4 of our decision. At least it is disclosed as to property damage or theft insurance, and the parties have not shown the existence of any other insurance covered by the disclosure in Section 12 of the contract.

In view of the foregoing, we have also reconsidered our dismissal of the other pleadings in this case, specifically this defendant's counterclaim, the complaint against Anderson Brothers Ford, and the crossclaim of Anderson against Ford Motor Credit Co. Since the plaintiffs' complaint is still partially viable, the other pleadings will also be reinstated and the Rule 58 judgment vacated. The plaintiffs' motion to dismiss the counterclaim will be reconsidered on its merits, no further briefing required.

The decision and order entered October 31, 1978 is vacated to the extent noted above. Defendants are ordered to file an answer to the complaint, the cross-defendant is ordered to answer the cross-claim, and plaintiffs' motion to dismiss

the counterclaim will be retained under advisement. All pleadings to be filed within ten (10) days hereof. This case will then be called for a report on status on Monday, December 4, 1978 at 11:30 a.m.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: Nov. 17, 1978

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs and Counterdefendants,

v.

ANDERSON BROS. FORD,
Defendant,

AND FORD MOTOR CREDIT COMPANY,
Defendant and Counterplaintiff.

ANSWER AND DEFENSES OF FORD MOTOR CREDIT COMPANY TO COMPLAINT

Ford Motor Credit Company ("Ford Credit"), by its undersigned attorneys, hereby answers and asserts defenses to the Complaint as follows:

FIRST DEFENSE

COUNT I

1. This is an action for statutory damages, attorneys' fees and costs based on the defendants' violations of the Truth-in-Lending Act, 15 U.S.C. § 1601 *et seq.*, ("TIL") and Regulation Z, 12 C.F.R. § 226 *et seq.*

1. Ford Credit admits the existence of the statute and regulation referred to in paragraph 1 and that the action purports to be brought under such statute and regulation, but denies the remaining allegations of paragraph 1 and specifically denies that Ford Credit has violated any law and that plaintiffs are entitled to any damages, attorneys' fees and costs.

> 2. This Court has jurisdiction over this case pursuant to TIL, § 1460(e) [sic].

2. Ford Credit does not contest the Court's subject matter jurisdiction over the claim alleged in Count I of the Complaint.

> 3. The plaintiffs Olga Valencia and Miguel Gonzalez are residents of Chicago, Illinois.

3. Ford Credit is without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 3.

> 4. Defendant Anderson is an Illinois corporation with its principal place of business in Berwyn, Illinois. Anderson is engaged in the business of selling automobiles to the general public on a retail installment basis.

4. Ford Credit admits that defendant Anderson Bros. Ford, Inc. ("Anderson") is an Illinois corporation engaged in the business of selling automobiles to the general public, and is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of paragraph 4.

> 5. Defendant Ford is a foreign corporation doing business in the state of Illinois. Ford is engaged in the business of financing automobile retail installment contracts.

5. Ford Credit admits that it is a corporation doing business in the state of Illinois and that it engages in the business of purchasing certain retail installment contracts, but denies the remaining allegations of paragraph 5.

> 6. At all times relevant hereto, Anderson and Ford were "creditors" as defined in TIL, § 1602(f) and Z, § 226.2(m), which in the ordinary course of business extend, or arrange for the extension of credit to natural persons of their personal, family or household use.

6. Ford Credit denies the allegations of paragraph 6.

7. On or about September 30, 1977, plaintiffs entered into a retail installment contract with Anderson for the purchase of a used 1974 Ford Pinto, serial No. 4X10Y285345, for their personal, family and household use. A copy of the contract is attached hereto as Exhibit A and made a part hereof.

7. Ford Credit admits that on or about September 30, 1977, plaintiffs entered into an Illinois Automobile Retail Installment Contract (the "Contract") with Anderson for the purchase of a used 1974 Pinto, serial number 4X10Y-285345. Ford Credit states that an Exhibit filed by plaintiffs appears to be a copy of part of the Contract but denies that said Exhibit was attached to the complaint as Exhibit A. Ford Credit is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of paragraph 7.

8. A clause of the contract provides that all claims and defenses may be equally asserted against Anderson and Ford.

8. Ford Credit states that the Contract speaks for itself, and therefore denies that the allegations of paragraph 8 fully and accurately summarize the provisions of the Contract.

9. Anderson subsequently assigned the Contract to Ford.

9. Ford Credit admits the allegations of paragraph 9 of the Complaint.

10. The contract discloses that the amount financed is $1340.00, the finance charge is $319.84 and the total of payments is $1659.84, which is to be paid in 24 installments of $69.16 each.

10. Ford Credit states that the Contract speaks for itself, and therefore denies that the allegations of paragraph 10 fully and accurately summarize the provisions of the Contract.

11. The defendants have violated TIL and Regulation Z in the course of this transaction in the following respects:

(a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of Regulation Z §§ 226.8(b)(5) and 226.8(a).

(b) By failing to disclose a retained security interest in insurance proceeds in violation of Regulation Z §§ 226.8(b)(5) and 226.8(a).

(c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of Regulation Z § 226.8(b)(6) and (7).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of 15 U.S.C. § 1638(a)(9) and Regulation Z § 226.8(b)(4).

(e) By failing to properly disclose Ford as a creditor in this transaction in violation of Regulation Z § 226.6(d).

11(a) Ford Credit denies the allegations of paragraph 11, subparagraph (a).

11(b)-(e) No answer to paragraph 11, subparagraphs (b)-(e) is required since this part of plaintiffs' complaint was dismissed by orders of this court dated October 31, 1978 and November 17, 1978, but if answer were required, Ford Credit would deny each and every such allegation.

COUNT II

1. This Count is an action against the defendants under the Illinois Motor Vehicle Retail Installment Sales Act, Ill. Rev. Stat., ch. 121½, §§ 561 *et seq.*, (MVRISA).

1. Ford Credit admits the existence of the statutes referred to in paragraph 1 and that the action purports to be brought under such statute, but denies the remaining allegations of paragraph 1 and specifically denies that Ford Credit has violated any law.

2. This court has pendent jurisdiction to adjudicate the claims set forth in this Count because the federal and state claims set forth in Counts I and II derive from a common nucleus of operative facts and are such that a plaintiff would ordinarily be expected to try them both in one judicial proceeding.

2. Ford Credit denies the allegations of paragraph 2.

3.-10. Plaintiffs reallege ¶¶s 3-10 of Count I as ¶¶s 3-10 of this Count II.

3.-10. Ford Credit refers to and incorporates by reference its answer to paragraphs 3-10 of Count I.

11. At all times relevant hereto, plaintiffs were buyers as defined in the MVRISA, § 562.2. Anderson was a seller as defined in the MVRISA, § 562.3. Ford was a sales finance agency and a holder as defined in the MVRISA, §§ 562.11 and 562.12, and the transaction was a retail installment transaction as defined in the MVRISA, § 562.4.

11. Ford Credit admits that Ford Credit was a "sales finance agency" as defined in § 562.11 of MVRISA and Ford Credit is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of paragraph 11.

12. Defendants have violated the MVRISA in the following respects

(a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of MVRISA, § 565(13).

(b) By failing to disclose a retained security interest in insurance proceeds in violation of MVRISA, § 565(13).

(c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of §§ 565(4) and (12).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of § 565(14) and (15).

12(a) Ford Credit denies the allegations of paragraph 12, subparagraph (a).

12(b)-(d) No answer to paragraph 12, subparagraphs (b)-(d) is required since this part of plaintiffs' complaint was dismissed by orders of this court dated October 31, 1978 and November 17, 1978, but if an answer were required, Ford Credit would deny each and every such allegation.

13. For the foregoing violations, § 584(b) of the MVRISA provides that the defendants may collect no finance charge, delinquency, or collection charge in connection with the retail installment contracts of the plaintiffs.

13. Ford Credit states that the statute cited in paragraph 13 speaks for itself, and denies the legal conclusions of the pleader set forth in paragraph 13.

SECOND DEFENSE

The Complaint fails to state a claim upon which relief can be granted.

THIRD DEFENSE

Ford Credit did not violate the Truth-in-Lending Act or MVRISA because the Contract on its face fully complies with all of the disclosure requirements of the Truth-in-Lending Act and MVRISA.

FOURTH DEFENSE

The allegations contained in paragraph 11, subparagraphs (b)-(e) in Count I and paragraph 12, subparagraphs (b)-(d) in Count II were dismissed by orders of this Court dated October 31, 1978 and November 17, 1978, are fully adjudicated between the parties, and are barred by the operation of the doctrines of law of the case and res judicata.

FIFTH DEFENSE

This court lacks jurisdiction to hear the alleged state law claim in Count II of the Complaint because of lack of pendent jurisdiction to entertain said claim.

SIXTH DEFENSE

Any construction under the Truth-in-Lending Act, Regulation Z or MVRISA which would find the assignment of returned or unearned insurance premiums appearing on the back of the Contract to be a violation of Regulation Z §§ 226.8(a) and 226.8(b)(5) and MVRISA § 565(13), would violate the Due Process Clauses under the Fifth and Fourteenth Amendments of the United States Constitution and Section 2 of Article 1 of the Illinois Constitution on the grounds of vagueness and ambiguity as applied of the terms of said statutes and Regulation.

SEVENTH DEFENSE

If the assignment of returned or unearned insurance premiums appearing on the back of the Contract is found to be a violation of the Truth-in-Lending Act and MVRISA, Ford Credit is nonetheless excused from liability because Ford Credit acted in good faith and in conformity with rules, regulations and interpretations issued by the Federal Reserve Board.

EIGHTH DEFENSE

If the asignment of returned or unearned insurance premiums appearing on the back of the Contract is found to be a violation of disclosure required under the Truth-in-Lending Act and MVRISA, Ford Credit is nonetheless excused from liability because any such violation was unintentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid any such error.

WHEREFORE, Ford Credit demands judgment dismissing Counts I and II of this action as to it, together with costs assessed against plaintiffs.

Dated: December 8, 1978

Aaron J. Kramer
Carl A. Royal
Richard R. Ertel

By /s/ Richard R. Ertel

Attorneys for Ford Motor Credit Company

Of Counsel:

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(Certificate of Service Omitted in Printing)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 B 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs and Counterdefendants,

VS.

ANDERSON BROS. FORD,
Defendant,

AND FORD MOTOR CREDIT COMPANY,
Defendant and Counterplaintiff.

MOTION FOR SUMMARY JUDGMENT

The plaintiffs, pursuant to Rule 56, Federal Rules of Civil Procedure, move this Court for the entry of a summary judgment in their favor on the issue raised in Count I, ¶ 11(a) of plaintiffs' complaint, in that no genuine issues of material fact are in dispute with regard to this question.

Plaintiffs further request this Court to set a briefing schedule on this motion.

/s/ ARMANDO ALMAZAN

Armando Almazan
One of Plaintiffs/Counterdefendants
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(Certificate of Service Omitted in Printing)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs and Counterdefendants,

vs.

ANDERSON BROS. FORD,
Defendant,

AND FORD MOTOR CREDIT COMPANY,
Defendant and Counterplaintiff.

DEFENDANTS' CROSS-MOTION FOR SUMMARY JUDGMENT

Defendant Anderson Bros. Ford ("Anderson Bros.") and defendant and counterplaintiff Ford Motor Credit Company ("Ford Credit"), by their undersigned attorneys, hereby move the Court pursuant to Rule 56 of the Federal Rules of Civil Procedure to enter summary judgment for both defendants on Count I, ¶ 11(a) of plaintiffs' complaint, the only allegation under the Truth-in-Lending Act not already dismissed by order of this court, on the grounds that there is no genuine issue as to any material fact and that Anderson Bros. and Ford Credit are entitled to summary judgment as a matter of law.

WHEREFORE Anderson Bros. and Ford Credit move this court to enter summary judgment for both defendants on Count I, ¶ 11(a) of plaintiffs' complaint.

Aaron J. Kramer
Carl A. Royal
Richard R. Ertel

By /s/ Richard R. Ertel
Attorneys for Anderson Bros. Ford and Ford Motor Credit Company

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(Certificate of Service Omitted in Printing)

DECISION OF THE DISTRICT COURT
JUNE 5, 1979

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

All parties have filed motions for summary judgment in this case which involves alleged violations of the Federal Truth in Lending Act and the Illinois Motor Vehicle Retail Installment Sales Act. The total amount being financed by the plaintiffs is $1,340.00, and the finance charge is $319.84. This is the fourth contested motion that has been presented in this case and, we trust, the last. We will enter summary judgment in favor of the plaintiffs.

The principal issue to be decided is whether or not the assignment of unearned or returned insurance premiums is a "security interest" which must be disclosed in the purchase contract, pursuant to 15 U.S.C. § 1638(a)(10) and 12 C.F.R. 226.8(b)(5) of Regulation Z.

In our decision of November 17, 1978 that such an assignment must be disclosed, we relied on *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978). Certiorari was denied in that case by the United States Supreme Court on May 14, 1979. 47 U.S.L.W. 3744. For the reasons stated in our foregoing decision and in the decision entered December 13, 1978, we believe that *Edmondson* is a correct statement of the law.

Defendants contend that, since plaintiffs made no payments under the contract and paid no insurance premiums but instead rescinded the transaction and consequently caused the insurance policy to be cancelled, the provisions of the above statute and regulation do not take hold. This is a specious argument, because Regulation Z applies to the contract, both at the time it is signed and *in futuro*, requiring disclosures whether or not any payments are made by the purchasers.

Nor does the fact that plaintiffs rescinded the transaction prevent them from collecting damages. Merely a violation of the statute and its regulations is sufficient to create plaintiffs' cause of action under 15 U.S.C. § 1640. See *Mulqueeny* v. *National Commission, etc.*, 549 F.2d 1115, 1120, n.15 (7th Cir. 1977); *White* v. *Arlen Realty & Development Corp.*, 540 F.2d 645 (4th Cir. 1975).

Defendants' alleged reliance on various publications emanating from the Federal Reserve Board is misplaced. In the first place, defendants do not support their alleged reliance with any affidavit or evidence. In fact, the Board's unofficial position at the time plaintiffs' contract was signed appeared to require proper disclosure of defendants' interest. See Public Position Letter No. 377, quoted in *Edmondson*, 577 F.2d at 295, f.n.8. Secondly, Federal Reserve Board letter No. 1263 is not a regulation but is merely an unofficial staff interpretation which, incidentally, was not released until two months after the contract in this case was signed. It does not have the force of a regulation. *Basham* v. *Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978). Finally, since we have already determined that the assignment of insurance premiums, whether paid or unpaid, is a "security interest" within the meaning of the Federal statute and regulation, we need not be concerned with whether or not this definition is consistent with

local state law. The enforcement or effect of a security interest in the local state courts is quite another matter, not involved under the Truth in Lending Act.

Plaintiffs are directed to serve and file an appropriate judgment order in their favor and against defendants within ten (10) days hereof which will dispose of Count I of the complaint. The pendent State law action in Count II will be dismissed without prejudice upon entry of Judgment on Count I.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: June 5, 1979

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

JUDGMENT

A decision having been rendered on motions for summary judgment filed by all parties,

IT IS ORDERED AND ADJUDGED:

1. That plaintiff Olga Valencia recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

2. That the plaintiff Miguel Gonzalez recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

3. The issue of attorney fees and costs is reserved. Plaintiffs shall file a motion for an award of attorney fees and costs within 15 days of the date of this judgment.

4. The counterclaim of the defendant Ford Motor Credit Company is dismissed without prejudice.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: June 15, 1979

UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF ILLINOIS—
EASTERN DIVISION

Civil Action File No. 78 C 1718

OLGA VALENCIA, *et al*

Plaintiffs

VS.

ANDERSON BROS. FORD, *et al*

Defendants

JUDGMENT

This action came on for (hearing) before the Court, Honorable Thomas R. McMillen, United States District Judge, presiding, and the issues having been duly (heard) and a decision having been duly rendered,

It is Ordered and Adjudged that plaintiff Olga Valencia recover of defendants jointly and severally the sum of $639.68 with interest at the legal rate.

It is ordered and adjudged that plaintiff Miguel Gonzalez recover of defendants jointly and severally, the sum of $639.68 with interest at the legal rate and with costs of the action.

Counterclaim of defendant Ford Motor Credit Co. is dismissed without prejudice.

Dated at Chicago, Illinois, this 15th day of June, 1979.

H. STUART CUNNINGHAM
Clerk of Court

By: /s/ KATHLEEN BRANCH
Deputy Clerk

OPINION BELOW OF THE COURT OF APPEALS

In the

United States Court of Appeals

For the Seventh Circuit

No. 79-1950

OLGA VALENCIA and MIGUEL GONZALEZ,

Plaintiffs-Appellees,

v.

ANDERSON BROS. FORD and FORD MOTOR CREDIT COMPANY,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 78 C 1718—**Thomas R. McMillen**, *Judge*.

ARGUED JANUARY 11, 1980—DECIDED MARCH 20, 1980

Before SWYGERT, SPRECHER and CUDAHY, *Circuit Judges*.

SPRECHER, *Circuit Judge*. Defendants, Anderson Brothers Ford and Ford Motor Credit Company (Ford), appeal from the district court's order finding them in violation of the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et seq.* and Regulation Z, 12 C.F.R. § 226.1 *et seq.*, and dismissing their counterclaim. This appeal presents three issues for our consideration. First, did defendants' failure to disclose an assignment of returned or unearned physical damage insurance premiums as a security interest violate the Act and Regulation Z. Second, if this court finds such a violation, should its ruling be given only prospective effect under the

doctrine of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Finally, did the district court properly dismiss without prejudice defendants' counterclaim for the balance of the debt allegedly owed by plaintiffs under the installment contract at issue in this case.

I

On September 30, 1977, in connection with the purchase of a used 1974 Ford Pinto from Anderson Brothers Ford, the plaintiffs signed an Illinois Automobile Retail Installment Contract. This contract was subsequently assigned for value to Ford Motor Credit Company. The contract revealed that the plaintiffs were borrowing a sum of $1340.00, over a twenty-four month period, at an annual rate of interest of 21.40%. Record on Appeal, Document No. 14, Appendix A.

The contract contains on its face the following disclosure with respect to retention of security interests by the creditor:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

Record on Appeal, Document No. 14, Appendix A. The reverse side of the contract contains a provision requiring the debtor to purchase and maintain physical damage insurance on the auto. While this insurance apparently may be purchased through the creditor and financed under the contract, the buyer is free to obtain such insurance elsewhere as well. Regardless of the source of the insurance, the contract provides that the debtor assigns to the creditor any returned or unearned premiums payable under the insurance policy. Such premiums may be used to purchase replacement insurance coverage or may be applied to the debt in the discretion of the creditor. Brief of Appellants at 9. In addition, the creditor is given authority to cancel the

insurance policy and release or settle any claim with respect thereto.[1]

Plaintiffs contracted to purchase the required insurance through Ambassador Insurance Company at an annual premium of $442.00. Because the auto was permanently returned to Anderson Brothers due to mechanical problems on October 17, 1977, no payments were made by plaintiffs on either the insurance policy or

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[1] The contract provides, in pertinent part:

> RISK OF LOSS—INSURANCE
>
> The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require.
>
> * * *
>
> If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

Record on Appeal, Document No. 14, Appendix A. The contract goes on to provide that a failure to maintain the required insurance constitutes a default giving rise to the creditor's rights of acceleration and repossession. *Id.*, ¶ 18.

the installment contract.[2] The policy was eventually cancelled for nonpayment of premiums.

On May 3, 1978, plaintiffs filed suit in the court below against Anderson Brothers and Ford, alleging various violations of the Truth in Lending Act, Regulation Z and the Illinois Motor Vehicle Retail Installment Sales Act, Ill.Rev.Stat. ch. 121½, § 561 *et seq.*, including defendants' failure to disclose the assignment of unearned insurance premiums as a security interest. On October 31, 1978, the district court dismissed plaintiffs' complaint for failure to state a claim on which relief could be granted. The court specifically found that an assignment of returned or unearned insurance premiums was not a security interest and thus need not have been disclosed as such on the face of the contract.

Subsequent to its October 31 decision, the district court was informed of the July 28 decision of the Fifth Circuit in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). On the basis of that decision, the district court reinstated that portion of plaintiffs' complaint which pertained to disclosure of the assignment of unearned insurance premiums as a security interest. The district court entered summary judgment for the plaintiffs on this claim on June 5, 1979, finding itself in agreement with *Edmondson* that an assignment of unearned insurance premiums is a security interest that must be disclosed under 15 U.S.C. § 1638(a)(10) and 12 C.F.R. § 226.8(b)(5). The court also dismissed plaintiffs' pendent state law claims. Defendants appeal from the district

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[2] In the court below, defendants argued that plaintiffs' failure to pay the required premiums somehow foreclosed any finding of a violation of the Act or Regulation Z. The district court rejected this argument, finding the payment or nonpayment of premiums irrelevant. Defendants apparently do not contest this ruling on appeal. As our recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), indicates, the fact that a debtor may have no present interest in property in which a security interest is claimed is irrelevant for purposes of the disclosure requirements of the TILA and Regulation Z. Slip op. at 3-6.

court's summary judgment order; plaintiffs do not appeal from the dismissal of their other claims.

Defendants also appeal from the district court's dismissal of their counterclaim. The counterclaim, filed shortly after plaintiffs filed the complaint, sought to recover the balance due from plaintiffs on the installment contract. The district court dismissed the counterclaim without prejudice in its judgment entered June 15, 1979. No explanation was given for the dismissal.

II

A

The federal Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, was enacted in 1968

> to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit . . . .

15 U.S.C. § 1601. The Act does not regulate consumer credit; rather, it requires disclosure of certain terms and conditions of credit before consummation of a consumer credit transaction. *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 874 (7th Cir. 1976). The Act is to be liberally construed to ensure achievement of its goal of meaningful disclosure. *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 262 (3d Cir. 1975).

One of the credit terms which must be disclosed under the Act is the retention or acquisition of any security interest by the creditor in a consumer credit transaction. 15 U.S.C. § 1638(a)(10).[3] The Act, however, nowhere

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[3] The statute provides, in pertinent part:

> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> * * *
>
> (10) A description of any security interest held or to be retained or acquired by the creditor in connection

(Footnote continued on following page)

defines "security interest." The Federal Reserve Board, pursuant to the authority vested in it under 15 U.S.C. § 1604,[4] promulgated Regulation Z, 12 C.F.R. § 226.1 *et seq.*, which defines "security interest" as follows:

[3] *continued*

with the extension of credit, and a clear identification of the property to which the security interest relates.

15 U.S.C. § 1638(a)(10). Regulation Z elaborates on this disclosure requirement as follows:

> (b) Disclosures in sale and nonsale credit. In any transaction subject to this section, the following items, as applicable, shall be disclosed:
>
> * * *
>
> (5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the propery to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

12 C.F.R. § 226.8(b)(5).

[4] Section 1604 provides:

> The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the pur-

(Footnote continued on following page)

> "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien or property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

12 C.F.R. § 226.2(gg). The issue before this court is whether this definition encompasses a debtor's assignment to a creditor of returned or unearned physical damage insurance premiums.

This court is not the first court of appeals to address this issue. Both the Third and Fifth Circuits have held that an assignment of unearned insurance premiums is a security interest which must be disclosed under the TILA and Regulation Z. See *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979); *Shanks v. Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978); *Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977).[5] *Edmondson* is

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[4] *continued*

> poses of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

15 U.S.C. § 1604.

The regulations promulgated by the Federal Reserve Board pursuant to this authority are entitled to deference by the courts and will be upheld as long as reasonably related to the purposes of the Act. *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369, 372 (1973).

[5] Defendants argue that *Gennuso* is not applicable in this case because it considered only the adequacy of disclosure of an assignment of unearned insurance premiums as a security interest and not whether such an assignment was a security interest at all. It is true, as defendants contend, that the *Gen-*

(Footnote continued on following page)

particularly damaging to defendants' case in that the contract at issue there does not differ in any material respect from the one now before us. Defendants do not attempt to distinguish *Edmondson*, but rather argue that it was wrongly decided and should not be followed by this court.

The heart of the *Edmondson* opinion, and the part which draws the greatest fire from defendants, is the Fifth Circuit's reliance on federal law, in the form of Regulation Z, rather than state commercial law to define a security interest for purposes of the TILA's disclosure requirements. Defendants argue that prior decisions of this court indicate that state law is to determine whether a security interest has been created requiring disclosure under the Act. See *Basham v. Finance America Corp.*, 583 F.2d 918, 924 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979); *Tinsman v. Moline Beneficial Finance Co.*, 531 F.2d 815, 818 (7th Cir. 1976).[6] Close examination of *Basham* and *Tinsman*

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[5] *continued*
nuso defendant conceded the assignment was a security interest for purposes of the Act. See *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461, 467 n.11 (W.D.Pa. 1976). However, the district court in *Gennuso* did not rely solely on this concession in finding that the installment contract created a security interest in the unearned premiums; the court specifically held that a security interest had been created and relied on the concession only for extra support. 425 F.Supp. at 467 & n.11. The Third Circuit noted its specific agreement with "the district court's determination that [the contract's provisions] create a security interest in the . . . unearned premiums of the insurance policy . . . ." 566 F.2d at 440 n.2. Both courts apparently considered this threshold issue properly before them despite the concession. Viewed in this context, *Gennuso* is a relevant precedent in the action before us. The Fifth Circuit was of the same opinion in *Edmondson*. See 577 F.2d at 294-95 & n.7.

[6] Defendants also cite *Croysdale v. Franklin Savings Ass'n*, 601 F.2d 1340 (7th Cir. 1979), as support for their contention that state law must be applied under the Truth in Lending Act. Reply Brief of Appellants at 10 n.*. This court looked to state law in *Croysdale* because of the Federal Reserve Board's deference to state rules of computation for certain transac-

(Footnote continued on following page)

reveals, however, that this court looked to state law in those cases to determine the scope or extent of security interests clearly claimed by creditors, not to determine whether an unidentified interest was indeed a security interest. This court's recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), reveals that an interest may be a security interest for purposes of disclosure under the TILA even though it is not an enforceable security interest under state commercial law. *Id.*, slip op. at 3-4.[7]

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[6] *continued*
tions. 601 F.2d at 1347. We specifically noted that Congress did not intend to incorporate conflicting and uncertain state law rules into the Act. The state rules of computation were properly consulted in that case because the substantive law of the state involved "[did] not subvert the purposes of the Act or Regulation." *Id.*

[7] Defendants suggest that *Butner v. U.S.*, 440 U.S. 48 (1979), requires this court to apply state law to determine whether a particular interest is a security interest for purposes of the TILA. In *Butner*, the Supreme Court held that state law is to determine whether a mortgagee has a security interest in certain rents and profits, for purposes of the federal Bankruptcy Act. *Id.* at 54-55. *Butner* is not applicable here for several reasons. First, an interpretation of the Bankruptcy Act sheds little light on the proper interpretation of the TILA; the two statutes differ fundamentally in nature and purpose. Second, the definitions applied for purposes of the Bankruptcy Act determine the enforceability of creditors' rights; under the TILA, definitions control only disclosure, not enforceability of substantive interests. Indeed, a principal concern in *Butner* was that a federal definition conferred property rights not conferred by state law, *id.* at 56; in the TILA context, state law continues to govern the substantive aspects of property interests, while federal law merely classifies interests for disclosure purposes. There is thus no federal encroachment upon areas traditionally governed by state law. Finally, even under the *Butner* rule, state law is to govern "[u]nless some federal interest requires a different result." *Id.* at 55. The federal interest in uniform disclosure of credit terms requires a uniform federal definition of the terms to be disclosed. See, e.g., *Mason v. General Finance Corp.*, 542 F.2d 1226, 1231, 1233 (4th Cir. 1976). Regulation Z provides such a uniform federal definition.

The Fifth Circuit's decision in *Edmondson* followed *a fortiori* from its earlier ruling in *Elzea v. National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978). In *Elzea*, the court held that state law characterizations of interests are not determinative for purposes of the disclosure requirements of the TILA. *Id.* at 1249-50. The court analyzed the rights conferred on the creditor by the contract to determine whether they fell within the Regulation Z definition of "security interest": "any interest in property which secures payment or performance of an obligation." 12 C.F.R. § 226.2(gg). This definition provides a straightforward, two-step approach to classification of interests for disclosure purposes. In both *Elzea* and *Edmondson*, the Fifth Circuit applied this two-step approach and found that the interests involved were security interests for TILA purposes.[8]

The *Elzea* analysis, which focuses on the nature of the substantive rights conferred on a creditor rather than on state law characterizations of those rights, was recently endorsed and applied by this court in *Bulger, supra*, slip op. at 5-6. This approach to the definition of "security interest" is reasonable, straightforward in application and furthers the federal interest in uniform disclosure of terms and conditions of consumer credit transactions. See *Edmondson, supra*, 577 F.2d at 295. We will accordingly continue to follow this approach.[9]

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[8] In both *Elzea* and *Edmondson*, the Fifth Circuit referred to the creditor's interest as a valuable economic right or privilege. *Edmondson, supra*, 577 F.2d at 294; *Elzea, supra*, 570 F.2d at 1250. Defendants and amici focus upon these references as if they formed the basis for the *Elzea* and *Edmondson* decisions. Our reading of the cases, however, reveals that these references were no more than additional support for the conclusions reached by application of the Regulation Z definition. We do not read *Elzea* and *Edmondson* to hold, as amici and defendants suggest, that a valuable privilege in the hands of a creditor, without more, is a security interest for purposes of the Act.

[9] Our research discloses that every federal court to consider whether an assignment of unearned insurance premiums is a security interest for TILA purposes since *Edmondson* has ex-

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State law is not necessarily to be ignored in determining whether a creditor's interest is a security interest for TILA purposes. Indeed, the Regulation Z definition of "security interest" lists a variety of security devices recognized under state law as examples of security interests under the Act. 12 C.F.R. § 226.2(gg).

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[9] *continued*
pressed agreement with that decision. See *Arias v. Albuquerque National Bank*, No. 78-352 (D.N.M. Jan. 5, 1979); *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979); *Murphy v. Ford Motor Credit Co.*, No. 78-1091C (A) (E.D.Mo. Aug. 29, 1979). The *Murphy* case does not specifically mention unearned insurance premiums; rather, it refers to "any monies payable" under the insurance policy. The court's citation of *Edmondson* as support for its conclusion, however, suggests that an assignment of unearned premiums was encompassed within the assignment of "any monies payable."

Defendants urge us to reject the three court of appeals and three district court decisions which adopt a position contrary to their own in favor of "better-reasoned case law." This "better-reasoned case law" consists of *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978). Neither decision persuades us to reject *Edmondson* and its progeny.

James is unconvincing because it specifically addresses only an assignment of insurance proceeds and does not refer to unearned premiums. While this may be analogous to the issue before us, it is hardly persuasive in the face of decisions which are directly on point. *Rounds*, on the other hand, does deal with an assignment of unearned premiums and finds that it is not a security interest under Illinois law and thus need not be disclosed. 454 F.Supp. at 887-88. The *Rounds* decision has been criticized for its apparent misinterpretation of *Mims v. Dixie Finance Corp.*, 426 F.Supp. 627 (N.D.Ga. 1976), a decision on which it heavily relies. See *Hernandez, supra*, slip op. at 3; *Arias, supra*, memo. op. at 8-9. Even if the *Rounds* interpretation of *Mims* were correct, reliance on *Mims*, a decision from the Fifth Circuit, is inappropriate after *Edmondson* and *Shanks*. *Rounds* nowhere mentions the specific definition of "security interest" contained in Regulation Z, 12 C.F.R. § 226.2(gg), when, in fact, that definition should be the starting point for any analysis of the question. In light of these factors, we cannot agree with defendants' contention that *Rounds* and *James* represent "better-reasoned case law."

As post-*Edmondson* decisions addressing the precise issue before us recognize, state law can indicate whether a creditor possesses an interest in property securing performance of an obligation; if such an interest is found to exist, federal law defines it as a security interest. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5; *Arias v. Albuquerque National Bank*, No. 78-532 (D.N.M. Jan. 5, 1979), memo. op. at 6-8. A creditor's substantive rights are still governed by state law; federal law merely classifies those rights for disclosure purposes.

Application of the Regulation Z definition of "security interest" in this case, as in *Edmondson*, poses no special problems. It is not seriously disputed that the assignment of unearned insurance premiums confers on the creditor an interest in property. Even defendants refer to the assignment as an "incidental interest in property." Brief of Appellants at 8. Whether incidental or not, we agree with the Fifth Circuit that such an assignment is an interest in property. 577 F.2d at 294. Similarly, we agree that this property interest secures the performance or payment of an obligation. The assigned premiums may be used, in the sole discretion of the creditor, to purchase replacement insurance coverage or to pay part of the debtor's indebtedness. In either case, the assignment secures an obligation of the debtor.[10] *Id.* at

[10] Indeed, defendants concede the assignment is intended to ensure that the insurance coverage which the debtor is obliged to obtain is maintained through the life of the installment contract. They state in their brief:

> Under the assignment provision in the Contract, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt.
>
> * * *
>
> The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles in order to obtain the return of unearned insurance

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294. The creditor has the authority to cancel the insurance and cause payment of unearned premiums to itself at any time. The contract clearly gives the creditor an interest in property which secures performance of a debtor's obligations. Such an interest is by definition a security interest for TILA purposes, 12 C.F.R. § 226.2 (gg), and as such must be disclosed. Defendants do not suggest that such disclosure was made in the contract before us.

We reach this conclusion despite the protests of defendants and amici that such an interpretation of the TILA upsets established industry practice and will cause extreme hardship for what is, at worst, a purely technical violation. While industry practice can be a useful guide in defining terms used in the TILA in the absence of a definition in the statute or Regulation Z, *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 265-66 (3d Cir. 1975), reliance on industry practice is misplaced where, as in this case, a term is clearly defined in the regulation or the Act. As for the imposition of undue hardship on the industry as a result of a purely technical violation of the Act, we repeat our recent observation:

> Congress did not intend that creditors should escape liability for merely technical violations. . . . [W]hile it may be true, in some sense, as the creditors have argued, that the terminological violations here are inconsequential, the fact remains that they are violations. Any misgivings which creditors may have about the technical nature of the requirements should be addressed to Congress or to the Federal Reserve Board, not to the courts.

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[10] *continued*
premiums, thereby causing lenders to lose insurance protection on the real "security" for such loans—the financed vehicles themselves.

Brief of Appellants at 9. The contract provides that the debtor's failure to maintain this insurance is, like a failure to pay the indebtedness, a default giving rise to creditor's remedies for default. Record on Appeal, Document No. 14, Appendix A, ¶ 18.

Smith v. No. 2 Galesburg Crown Finance Corp., Nos. 78-2145, *et al.* (7th Cir. Jan. 15, 1980), slip op. at 15, *citing Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977). See also *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 578 (9th Cir. 1977).

We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue.[11] In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

B

Alternatively, defendants argue that even if an assignment of unearned insurance premiums must be disclosed as a security interest, they have an absolute defense, under section 1640(f), to liability under the TILA because they acted in good faith in conformity with published interpretations of the Federal Reserve Board. Section 1640(f) provides:

> No provision of this section or section 1611 of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or

[11] FRB Public Position Letter No. 377 (July 22, 1970). This letter is reproduced in full in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291, 295 n.8 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979).

> omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

15 U.S.C. § 1640(f). Defendants contend that the district court erred in rejecting this defense as a matter of law. They allege several specific errors to support this contention. First, the district court required that they prove actual reliance on a Federal Reserve Board regulation or interpretation, whereas section 1640(f) only requires "conformity with" such authority. Second, defendants' good faith is an issue of material fact under section 1640(f), thereby precluding summary judgment. Finally, the court, in rejecting the defense, addressed only one of the interpretations cited by defendants, ignoring defendants' conformity with other interpretations and Regulation Z itself.

We need not address defendants' first two objections,[12] because they failed in the district court and this court to make the threshold showing required under section 1640(f). To avoid summary judgment, a defendant relying on section 1640(f) may not rest on a conclusory allegation that it acted in conformity with Board interpretations. The defendant must point to specific regulations or interpretations which support its position. *Arias v. Albuquerque National Bank*, No. 78-532 (D. N.M. Jan. 5, 1979), memo. op. at 4; *Gillard v. Aetna Finance Co.*, 414 F.Supp. 737, 749 (E.D.La. 1976). Defendants have been unable to identify any such regulations or interpretations.

Defendants direct us to three sources as the foundation of their section 1640(f) defense. First, they argue that they acted in conformity with the Regulation Z

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[12] This circuit has not yet determined whether actual reliance is required under section 1640(f) or whether accidental conformity is sufficient. See *Basham v. Finance America Corp.*, 583 F.2d 918, 923 n.7 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Other circuits have required actual reliance. See, e.g., *Ives v. W. T. Grant Co.*, 522 F.2d 749, 758 (2d Cir. 1975). At any rate, it is not at all clear that the district court required proof of actual reliance.

definition of "security interest." 12 C.F.R. § 226.2(gg). As they read this provision, it does not include mere "incidental interests" such as that involved in this case. It is clear, however, that a creditor's mistaken interpretation of Regulation Z, even if honest and reasonable, is not a defense under section 1640(f). *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 579 (9th Cir. 1977).

Defendants also cite several official Board interpretations as support for their position that state law must be consulted to determine whether a security interest has been created. See 12 C.F.R. § 226.202; Official Staff Interpretation FC-0023, Appendix to 12 C.F.R. at 606-07; Official Staff Interpretation FC-0071, Appendix to 12 C.F.R. at 642-43; Official Staff Interpretation FC-0095, Appendix to 12 C.F.R. at 657-59. None of these interpretations concern interests even remotely similar to an assignment of unearned insurance premiums. Furthermore, as discussed in the margin, the interpretations do not stand for the proposition that the definition of "security interest" for purposes of the TILA is to be governed by state commercial law.[13] Defendants cannot rely on these interpretations to support their section 1640(f) defense.

Finally, defendants refer to Federal Reserve Board Staff Opinion No. 1263, CCH Cons. Cred. Guide ¶31,736 (Nov. 23, 1977). While this interpretation might be said

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[13] Interpretation FC-0023 does not address the definition of "security interest"; rather, it concerns only the adequacy of disclosure of an interest admitted to be a security interest. Interpretation FC-0071 concerns the adequacy of disclosure of a security interest; state law is relevant not to the creation of the security interest but only to its scope. The interpretation at 12 C.F.R. § 266.202 examines state law as to the substantive effect of judgment clauses and cognovit provisions. Such provisions are then classified as security interests according to their substantive effect under state law; this is precisely the *Elzea-Edmondson* approach adopted here. Finally, FC-0095 is a complex discussion of disclosure of security interests in consumer leasing transactions which neither clearly supports nor clearly refutes defendants' position.

to support defendants' position,[14] it is insufficient for section 1640(f) purposes for two reasons. First, it is an unofficial interpretation. This court has specifically held that conformity with unofficial staff opinion letters will not satisfy section 1640(f). *Basham v. Finance America Corp.*, 583 F.2d 918, 925 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Second, Opinion No. 1263 was issued after execution of the contract at issue here. A creditor cannot claim to have acted in conformity with an interpretation issued after the relevant transaction has been completed. *McGowan v. Credit Center of North Jackson, Inc.*, 546 F.2d 73, 77 (5th Cir. 1977). Thus, Opinion No. 1263 is of little use to the defendants in this case.

The district court properly rejected defendants' section 1640(f) defense as a matter of law. Defendants' failure to identify specific official Board interpretations or regulations which supported their position was fatal to this defense and rendered unnecessary any inquiry as to defendants' good faith or actual reliance. We accordingly affirm the district court's ruling that defendants violated the TILA and Regulation Z.

III

Defendants contend that if this court decides to affirm the district court's judgment, as it has, the ruling should be given only prospective effect except as to the plaintiffs. The circumstances under which a judicial decision will be denied full retroactive effect are defined in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971):

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly

[14] One court which addressed this precise contention found that Opinion No. 1263 did not support such a position and that it was not at all inconsistent with the result in *Edmondson*. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5, 7.

> foreshadowed . . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-07 [citations omitted]. Because prospective-only application is the exception rather than the rule, the party seeking to invoke *Chevron Oil* bears the burden of proving that such limited application is justified. *Jimenez v. Weinberger*, 523 F.2d 689, 704 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976). All three of the factors listed in *Chevron Oil* must be shown to favor prospective-only application before a decision will be denied retroactive effect. *Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287, 1294 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

The defendants have failed to bear their burden on this issue. They have convinced this court neither that our decision overrules clear past precedent nor that it resolves an issue of first impression whose resolution was not clearly foreshadowed. At the time the parties entered the transaction at issue here, only one lower court decision clearly supported defendants' position. *Shanks v. Greenbriar Dodge, Inc.*, No. C75-1154A (N.D.Ga. Dec. 16, 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978). Another decision in the same district had reached the opposite result, holding that an assignment of unearned insurance premiums was a security interest for TILA purposes. *Edmondson v. Allen-Russell Ford, Inc.*, C75-940A (N.D.Ga. Apr. 29, 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). Similarly, the district court in *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd*, 566 F.2d 437 (3d Cir. 1977), prior to the transac-

tion in this case, had ruled that such an assignment created a security interest; the court imposed no liability, however, because it found the disclosure in that case adequate. In addition, the only relevant Federal Reserve Board interpretation issued prior to this transaction, Public Position Letter No. 377 (July 22, 1970), counselled disclosure of an analogous assignment as a security interest. The decisions on which defendants place the greatest reliance, *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978), were both decided after the instant contract was executed and thus cannot be clear prior precedent on which defendants may have relied.

Our examination of these authorities reveals that, at the time of the execution of the contract in this case, clear precedent did not support defendants' interpretation of the TILA. In fact, the weight of authority, such as it was, favored the opposite interpretation. At the present time, the weight of authority, now quite substantial, is in accord with the result reached in this case. It likewise cannot be said that this decision resolves an issue of first impression in a manner not foreshadowed by earlier authorities. The issue, while before this court for the first time, had been considered by several federal courts prior to the instant transaction. At least one of those decisions, the district court's opinion in *Edmondson*, reached the result reached here. One other decision, by the district court in *Gennuso*, differs from our decision in this case only on the issue of adequacy of disclosure, not on whether the assignment created a security interest. The Federal Reserve Board's resolution of a closely analogous issue in Public Position Letter No. 377 suggested the same result. To say that our decision in this case resolved an issue of first impression in a manner not foreshadowed by earlier authorities is to ignore reality.[15]

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[15] Defendants cite *McDaniel v. Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978) (en banc) as proof that prospective-only application of judicial decisions interpreting the TILA is

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Having decided that our ruling in this case establishes no new principle of law, it is unnecessay to address the remaining prongs of the *Chevron Oil* test. *Jordan v. Weaver*, 472 F.2d 985, 996 (7th Cir. 1973), *rev'd on other grounds sub nom. Edelman v. Jordan*, 415 U.S. 651 (1974). Nonetheless, we note that defendants have failed to persuade us that retroactive application of our ruling will retard the operation of the TILA or cause undue hardship. The Act requires disclosure of security interests as defined by Regulation Z. Our ruling merely implements that requirement. It does not disturb any clear rulings or precedents on which defendants may have relied to their detriment. We can see no inequity in its retroactive application.[16] We find, therefore, that

[15] *continued*
sometimes appropriate. *McDaniel*, while it may stand for that proposition, also indicates the limited circumstances in which such application will be decreed. Prospective application was ordered in *McDaniel* because the Fifth Circuit's decision in that case overruled an earlier decision by a panel of the same court. See *Martin v. Commercial Securities Co.*, 539 F.2d 521 (5th Cir. 1976). *McDaniel* is a far cry from the present case in which defendants can point to no clear rule in this or any other circuit on which they may have relied.

[16] As plaintiffs point out, defendants are not in an ideal position to claim that retroactive application of our ruling will cause undue hardship. Ford Motor Credit was a defendant in the *Edmondson* litigation. Ford learned on July 28, 1978, when *Edmondson* was decided by the Fifth Circuit, that at least one court of appeals considered its failure to disclose an assignment of unearned insurance premiums as a security interest a violation of the TILA. Despite this decision, Ford continued to use, in other circuits, a form contract which had been held to violate the Act in the Fifth Circuit. Ford was certainly entitled to do so since *Edmondson* was not the law in other circuits. However, in doing so Ford was gambling that its view of the law would prevail over the *Edmondson* view in subsequent suits. The fact that Ford now faces the consequences of losing its conscious gamble hardly presents a case of inequitable hardship. If the relevant provisions of Ford's contract had been modified in accordance with *Edmondson* within a reasonable time after that decision, Ford would be immune from any additional liability for this violation of the Act by virtue of the Act's one year statute of limitations. 15

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prospective-only application of our decision in this case under the *Chevron Oil* doctrine is inappropriate. Defendants have failed to convince this court that any of the three *Chevron Oil* factors are present in this case.

IV

Defendants' final contention is that the district court erred in dismissing Ford's counterclaim for the balance allegedly owed by plaintiffs under the installment contract. Ford argues that dismissal was improper because the counterclaim is compulsory under Fed. R. Civ. P. 13(a).[17] It is clear that a compulsory counterclaim is within the ancillary jurisdiction of a district court and thus can proceed to trial even where the plaintiff's claim is disposed of prior to trial. *Plant v. Blazer Financial Services, Inc.*, 598 F.2d 1357, 1359 (5th Cir. 1979). A permissive counterclaim, however, cannot be entertained in federal court absent an independent basis for federal jurisdiction. *Whigham v. Beneficial Finance Co.*, 599 F.2d 1322, 1323 (4th Cir. 1979). There is no independent basis for jurisdiction over Ford's counterclaim in this case, so the issue is whether the counterclaim is permissive or compulsory.

There is a conflict between the Fourth and Fifth Circuits on this issue. The Fourth Circuit, in *Whigham*,

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[16] *continued*
U.S.C. § 1640(e). The *Chevron Oil* doctrine is not directed at insulation of litigants from the consequences of their conscious business decisions; rather, its purpose is to avoid the hardship which can result from retroactive application of decisions which represent sudden, unexpected shifts in the law. This is not such a case.

[17] Rule 13(a) provides, in pertinent part:

> (a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.
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> * * * *

Fed. R. Civ. P. 13(a).

supra, held that while a TILA claim and a debt counterclaim may, in a technical sense, arise from the same loan transaction, the two claims bear no logical relationship to one another. A debt counterclaim "has none of the characteristics associated with a compulsory counterclaim," 599 F.2d at 1323, and thus is permissive rather than compulsory. The Fifth Circuit has taken the opposite view. In *Plant*, *supra*, the court found that the claims are obviously interrelated and derived from a common factual basis; they are, therefore, logically related. On this basis the court held that a debt counterclaim is compulsory in a debtor's TILA suit. 598 F.2d at 1363-64. Both courts acknowledged that the majority of district courts to have considered the issue have ruled that debt counterclaims are permissive. See *Plant*, *supra*, 598 F.2d at 1361; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.[18]

The Fourth and Fifth Circuits both applied the "logical relationship" test to the debt counterclaims before them. This court considers the logical relationship test crucial in determining whether a claim and counterclaim arise from the same transaction or occurrence for purposes of Rule 13(a). We have observed that whether a particular counterclaim should be considered conpulsory depends not so much on the immediacy of its connection with the plaintiff's claim as upon its logical relationship to that claim. *Warshawsky & Co. v. Arcata National Corp.*, 552 F.2d 1257, 1261-63 (7th Cir. 1977). This test is to be applied flexibly in order to further the policies of the federal rules in general and Rule 13(a) in particular. *Id.* at 1261.

In *Plant*, *supra*, the Fifth Circuit analyzed the reasoning employed by many district courts to hold debt counterclaims permissive even where a literal application of the language of Rule 13(a) would suggest the opposite result. The primary concern of these courts was that enforcement of the TILA would be impaired if debt

[18] Both *Plant* and *Whigham* list the relevant lower court opinions. See *Plant*, *supra*, 598 F.2d at 1361-64, 1363 nn.10, 11; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.

counterclaims were compulsory because TILA plaintiffs would often be faced with counterclaims exceeding their potential recovery under the Act. In addition, TILA claims could not be expeditiously resolved if courts were entangled in the state law issues raised by debt counterclaims. 598 F.2d at 1361. The Fifth Circuit found that these and other concerns were outweighed by the interests in judicial economy and in providing complete relief to a defendant in a single lawsuit. *Id.* at 1363-64.

We disagree with the Fifth Circuit's analysis. The sole connection between a TILA claim and a debt counterclaim is the initial execution of the loan document. A flexible application of the logical relationship test reveals that this connection is so insignificant that compulsory adjudication of both claims in a single lawsuit will secure few, if any, of the advantages envisioned in Rule 13(a). As one court analyzed this issue:

> The link is credit extension, a fact established on the face of the pleadings, but the federal claim and state counterclaim do not stand on common ground when realistically assessed; the critical legal inquiry into each "half" of the controversy is so distinct that the parties' disputes are actually fragmented whether pursued through two actions or as separate aspects of one. In these circumstances, wooden application of the common transaction label does not yield real judicial economy; any perceived logical nexus is conceptual, abstract, a formal characterization rather than a recognition of concrete advantage to be achieved through single forum adjudication of all the parties' opposing claims. Even if inappropriate to weigh in the balance those policy considerations against federal court intervention, . . . in examining the state law counterclaim for purposes of Rule 13 this Court need not disregard the crucial factor of practical importance that the truth in lending complaint and debt counterclaim lack any shared realm of genuine dispute.

Ball v. Connecticut Bank & Trust Co., 404 F.Supp. 1, 4 (D.Conn. 1975) [citation omitted].

The TILA claim and debt counterclaim raise different legal and factual issues governed by different bodies of law. A TILA suit for inadequate disclosure, such as the instant case, can often be resolved by an examination of the face of the loan document. A debt counterclaim, on the other hand, can raise the full range of state law contract issues.[19] The two claims do not, as the Fifth Circuit held, spring from the same "aggregate of operative facts." *Plant, supra,* 598 F.2d at 1361. The rights and obligations of the parties with respect to the two claims hinge on different facts and different legal principles. We concur in the Fourth Circuit's characterization of the relationship between the claims:

> The lender's counterclaim alleges simply that the borrower has defaulted on a private loan contract governed by state law. The borrower's federal claim involves the same loan, but it does not arise from the obligations created by the contractual transaction. [citation omitted] Instead, the claim invokes a statutory penalty designed to enforce federal policy against inadequate disclosure by lenders.

Whigham, supra, 599 F.2d at 1324. Such claims are not logically related to one another and resolution of both in a single suit will not further the purposes of Rule 13(a).

Similarly, we concur in the Fourth Circuit's observation that permitting a creditor to "use the federal proceedings as an opportunity to pursue private claims against the borrower would impede expeditious enforcement of the federal penalty . . . ." *Id.* at 1324. In the absence of a relationship between the claims which will further the purposes of Rule 13(a), we decline to employ a mechanical interpretation of that rule in a way which will impede enforcement of an important federal statute.

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[19] It is true, as the Fifth Circuit observed, that a district judge is presumed competent to resolve such state law issues. *Plant, supra,* 598 F.2d at 1363, 1364. However, the fact that these issues can be capably resolved in a single suit does not indicate that they are best resolved in a suit raising federal claims unrelated to the substance of the loan agreement or any question of performance or default.

The result reached by the Fourth Circuit is consistent with prior decisions of this court[20] and the flexible approach to Rule 13(a) mandated in this circuit. Ford's counterclaim was dismissed without prejudice, so it is free to pursue its claim in state court. Accordingly, we affirm the district court's dismissal of Ford's counterclaim.

Having considered defendants' arguments and finding all without merit, we affirm the judgment appealed from in all respects.[21]

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[20] The Fourth Circuit in *Whigham* found that this court's decision in *Basham v. Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979), supported its conclusion. 599 F.2d at 1323 n.*, 1324. In *Basham*, we noted, in a different context, that a "TILA claim is not directed at or an answer to the underlying debt." 583 F.2d at 928. We also acknowledged that some district courts had found TILA claims and the underlying debt "not so related as to be the subject of a compulsory counterclaim . . . ." *Id.* at 928 n.18.

It is also interesting to note that in this portion of the appeal defendants ignore *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978), on which they relied so heavily elsewhere. In *Rounds*, the court dismissed the lender's counterclaim, observing that:

> This court has consistently held that a counterclaim upon the underlying credit obligation is not a compulsory counterclaim in a TILA action.

Id. at 890.

[21] We have examined *Ford Motor Credit Co. v. Milhollin*, 48 U.S.L.W. 4145 (Feb. 20, 1980), cited by defendants pursuant to Circuit Rule 11. As defendants state,

> *Milhollin* shows the critical importance of having a formal FRB interpretation that creditors may unhesitatingly rely upon as a complete defense under Section 1640(f) of the Act. . . .

In *Milhollin*, an official interpretation issued by the Board's staff directly supported the position taken by the defendant creditors. The Supreme Court found that section 1640(f) of the Act signalled a congressional decision to treat such official interpretations, whether by the Board or its staff, as authoritative. See 48 U.S.L.W. at 4148 & n.9. This "special status" was not, however, conferred under section 1640(f) upon

(Footnote continued on following page)

CUDAHY, *Circuit Judge*, concurring. Judge Sprecher's opinion for the panel is exemplary in its logic, learning, legal analysis and lucidity of expression. But I do not read it as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. Among these meritorious purposes are the disclosure to buyers of the costs of credit and the alerting of customers to the possibility that their property may be reached to satisfy the obligation which they have incurred.

Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.

To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit.

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[21] *continued*
unofficial interpretations. See *id.* at 4148 n.10. In the present case, there is no official interpretation by the Board or its staff as to the proper treatment of an assignment of unearned insurance premiums. That such an interpretation might be desirable or even "critical" from the credit industry's viewpoint does not alter the fact that no official Board interpretation supports defendants' position in this case. The Board's failure to issue an official interpretation does not indicate that our ruling should be given only prospective effect. That decision is governed by the *Chevron Oil* criteria discussed in Part III, *supra*. Our examination of those criteria reveals that this is not an appropriate case in which to issue a prospective ruling. *Milhollin* does not require a different result.

As Senator Proxmire has said:

> "As sponsor of the original Truth in Lending Act I am becoming more and more concerned that its beneficial purposes are being frustrated by unnecessarily complex disclosure requirements which consumers may ignore or fail to understand.
>
> "In addition, the very complexity of the requirements may impose significant costs and other burdens on creditors despite their good faith efforts to comply with the law." 122 Cong. Rec. 23609 (1976).

I concur today with this Court's good faith efforts to apply (or comply with) the law, but I feel some concern about the purposes for which we are laboring. I hope that the important ends of credit disclosure will not be obscured in a whirl of litigious gamesmanship.

SWYGERT, *Circuit Judge*, concurring. Judge Sprecher's impeccable logic compels me to concur in his opinion and to approve the result we announce. I do so reluctantly, however, because of the concerns—which I share—that are expressed by Judge Cudahy in his concurrence.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

USCA 4512—Midwest Law Printing Co., Inc., Chicago—3-20-80—350

ORDER OF THE COURT OF APPEALS

MARCH 20, 1980

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

March 20, 1980

Before

Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

ORDER OF THE COURT OF APPEALS DENYING PETITION FOR REHEARING

APRIL 22, 1980

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

April 22, 1980.

Before

Hon. LUTHER M. SWYGERT, Circuit Judge

Hon. ROBERT A. SPRECHER, Circuit Judge

Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *in banc* filed in the above-entitled cause by defendants-appellants, no judge in active service has requested a vote thereon, and a majority of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

ACCOUNT NO. _____ **ILLINOIS AUTOMOBILE RETAIL INSTALLMENT CONTRACT** DA _____

Buyer (and Co-Buyer) - Name and Address (Include - County and Zip Code)

OLGA A. VALENCIA + MIGUEL GONZALES
3431 S. RIDGEWAY
CHGO, ILL 60623

Seller - Name and Address

Anderson Bros Ford
6539 Ogden Ave.
Berwyn, IL 60402

Buyer (which means the undersigned Buyers and Co-buyers, jointly and severally) having been quoted both a deferred payment price and a lesser cash price hereby purchases from **Seller** on a deferred payment price basis, upon the terms and conditions set forth on the face and reverse sides hereof, the following property (hereinafter called the "Property") delivery and acceptance of which in good order hereby are acknowledged by Buyer.

New or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Manufacturer's Serial Number	Use For Which Purchased
U	74 Ford	Pinto	3dr.	4		4X10Y785345	☒ Personal ☐ Business ☐ Agriculture

INCLUDING:
☒ Radio ☐ Air Conditioner ☒ Automatic Transmission ☐ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☒ Service Contract

DESCRIPTION OF TRADE IN

_____ (Year and Make) $ _____ (Gross Allowance)

$ — (Amount Owing)

OPTIONAL INSURANCE

Buyer authorizes Seller to obtain the following insurance coverages:

(a) **Physical Damage Insurance:** Coverages checked below for a term of ____ months (or for such shorter term as the insurer to whom Seller shall apply therefor will provide for the amount included herein) from the date hereof, payable to Buyer or Seller as interests may appear:

☐ Comprehensive ☐ Fire-Theft & Combined Additional Coverage
☐ $ _____ Deductible Collision ☐ Towing & Labor Costs ($25.00 Limit)
$ — (a)

(b) **Credit Life Insurance** on the life of _____ (Insured Person) for the term of this Contract. —

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date.

$ — (b)

(c) **Credit Accident and Health or Disability Insurance** provided by

DETAILS OF TRANSACTION

(1) Cash Price		$ 3340.00 (1)
Cash Down Payment	$ 1,000.00	
Trade In (See Opposite)	$ —	
(2) Total Down Payment		$ 1,000.00 (2)
(3) Unpaid Balance of Cash Price (Difference between Items 1 & 2)		$ 2340.00 (3)
(4) Other Charges	Service Contract	$ —
Optional Insurance (See Opposite)	$ —	
Official Fees	$ —	
Taxes (Not included in Cash Price)	$ —	
License, Title & Registration Fees	$ —	
Total Other Charges		$ — (4)
(5) Unpaid Balance - Amount Financed		$ 2340.00 (5)
(6) **FINANCE CHARGE**		$ 319.59 (6)
(7) **ANNUAL PERCENTAGE RATE**	21 1/4 %	(7)
(8) Total of Payments (Sum of Items 5 & 6)		$ 2659.59 (8)

(9) **Payment Schedule:** Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 99.00 each and one final instalment of $ 99.59 on the like day of each month commencing NOV 2 1973, or, if no date is specified, one month after the date of this contract.

☐ $_____ Collision ☐ ($25.00 Limit) _____

(b) Credit Life Insurance on the life of _____ for the term of this Contract. (Insured Person)

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date. $_____ (b)

(c) Credit Accident and Health or Disability Insurance provided by _____ for the term of this Contract in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date..... $_____ (c)

(d) Other Optional Insurance _____ (Itemize) $_____ (d)

Total Cost of Optional Insurance..... $_____

NOTICE TO BUYER: (1) You are not required to obtain the Credit Life and/or Credit Accident and Health or Disability Insurance for which a charge is indicated above and such is not a factor in the Seller's approval of this credit. Such insurance may be cancelled from its inception within 15 days from the date hereof by written request from each Buyer and any Guarantor. Upon cancellation, the entire charge therefor shall be refunded or credited to Buyer. (2) You have the right to choose the person through whom the Physical Damage Insurance required under this contract is to be obtained. ACKNOWLEDGING the foregoing, BUYER requests and authorizes SELLER to obtain each insurance coverage for which an amount is included above.

Buyer _____ Date _____

_____ Date _____

(Cost Of Insurance To Be Included Only If Signed By Each Insured Buyer And Dated)

LIABILITY INSURANCE COVERAGE FOR BODILY INJURY AND PROPERTY DAMAGE CAUSED TO OTHERS IS NOT INCLUDED.

CREDIT LIFE INSURANCE ELIGIBILITY

Credit life insurance under Ford Life Insurance Company's Group Policy No. 2200 is available only on the life of one natural person who is obligated to make payments under this retail instalment instrument and who is under the age of 66 on the date hereof. Benefits will be limited to a refund of premiums if there is no person eligible for such insurance, or if death results from suicide within one year from the date hereof or from certain pre-existing diseases or conditions within ninety days from the date hereof. For details see Notice of Proposed Group Credit Life Insurance on reverse side of Buyer's Copy.

The foregoing contract hereby is accepted by the Seller and assigned to Ford Motor Credit Company in accordance with the terms of the Assignment set forth on the reverse side hereof.

Seller _____

By _____ Title _____

Total Other Charges $ _____ (4)

(5) Unpaid Balance – Amount Financed $ 1340.00 (5)

(6) FINANCE CHARGE $ 319.84 (6)

(7) ANNUAL PERCENTAGE RATE 21.44 % (7)

(8) Total of Payments (Sum of Items 5 & 6) $ 1659.84 (8)

(9) Payment Schedule: Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 69.56 each and one final instalment of $ 69.44 on the like day of each month commencing NOV 2 19 79, or, if no date is specified, one month after the date of this contract.

(10) Deferred Payment Price (Sum of Items 1, 4 & 6) $ 1659.84 (10)

(11) Delinquency Charges: Buyer hereby agrees to pay a delinquency charge on each instalment in default for more than 10 days in the amount of 5% thereof or $5.00, whichever is less, plus such expenses incurred by Seller in effecting collection hereunder as may be allowed by law.

(12) Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

(13) Prepayment Rebate: Buyer may prepay his obligations under this contract in full at any time prior to maturity of the final instalment hereunder, and, if he does so, shall receive a rebate of the unearned portion of the Finance Charge computed under the sum of the digits method after first deducting an acquisition fee of $25.00. No rebate will be made if the amount thereof is less than $1.00.

(14) Additional Terms and Conditions: The additional terms and conditions set forth on the reverse side hereof are a part of this contract and are incorporated herein by reference.

NOTICE TO THE BUYER

1. **Do not sign this agreement before you read it or if it contains any blank spaces.**
2. **You are entitled to an exact copy of the agreement you sign.**
3. **Under the law you have the right, among others, to pay in advance the full amount due and to obtain under certain conditions a partial refund of the finance charge.**

Buyer acknowledges receipt of a true and completely filled in copy of this contract at time of signing.

RETAIL INSTALLMENT CONTRACT

Buyer Signs _____

Co Buyer Signs Miguel Gonzalez

Guarantor Signs _____

I hereby guarantee the collection of the above described amount upon failure of the seller named herein to collect said amount from the buyer named herein.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

BUYER'S COPY

ADDITIONAL TERMS AND CONDITIONS

15. ASSIGNMENT

The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

16. USE OF PROPERTY – WARRANTIES

Buyer shall keep the Property free from all encumbrances, and any amount that may be paid by Seller in release or discharge thereof shall be paid by Buyer to Seller forthwith upon demand with interest at the highest lawful contract rate. Buyer shall not use the Property illegally, improperly or for hire (unless stated herein) and shall not remove the Property from the county of his residence without the written permission of Seller. **No representation, promise or warranty, express or implied, has been made with respect to the merchantability, suitability or fitness for purpose of the Property or otherwise unless the same is endorsed hereon in writing or is contained in a separate written instrument signed by the original Seller.**

RISK OF LOSS – INSURANCE

The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require. The inclusion of a charge for insurance herein shall not relieve Buyer of such obligation but only authorizes Seller to attempt to obtain the requested coverages on Buyer's behalf through an authorized agent; provided, if Seller is unable to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

18. DEFAULT

Time is of the essence of this contract. In the event Buyer defaults in any payment, or fails to obtain or maintain the insurance required hereunder, or fails to comply with any other provision hereof, or a proceeding in bankruptcy, receivership or insolvency shall be instituted by or against Buyer or his property, or Seller deems the Property in danger of misuse or confiscation, or Seller otherwise reasonably deems the indebtedness or the Property insecure, Seller shall have the right to declare all amounts due or to become due hereunder to be immediately due and payable and Seller shall have all the rights and remedies of a Secured Party under the Uniform Commercial Code, including the right to repossess the Property wherever the same may be found with free right of entry, and to recondition and sell the same at public or private sale. Upon request, Buyer shall deliver the Property to Seller at a place designated by Seller. Seller shall have the right to retain all payments made prior to repossession and Buyer shall remain liable for any deficiency. Any personalty in or attached to the Property when repossessed may be held by Seller without liability and Buyer shall be deemed to have waived any claim thereto unless written demand by certified mail is made upon Seller within 24 hours after repossession. Buyer agrees to pay reasonable attorneys' fees (15% if permitted by law) and other expenses incurred by Seller in effecting collection, repossession or resale hereunder. Seller's remedies hereunder are in addition to any given by law and may be enforced successively or concurrently. Waiver by Seller of any default shall not be deemed a waiver of any other default.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder together with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor _____ Address _____

Guarantor _____ Address _____

able to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder togetner with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor _____ Address _____

Guarantor _____ Address _____

FORD LIFE INSURANCE COMPANY
NOTICE OF PROPOSED GROUP CREDIT LIFE INSURANCE

Notice hereby is given that if a charge for group credit life insurance to be provided by Ford Life Insurance Company, Dearborn, Michigan, under its Group Policy No. 2200 is separately stated as a part of the balance payable under the annexed retail instalment instrument, and if such instrument is assigned or otherwise transferred to Ford Motor Credit Company, the group policyholder, and if the person to be insured is eligible for such insurance as hereinafter provided, life insurance protection under the said Group Policy will be provided upon the life of such person with respect to such instrument. Any natural person is eligible for such insurance if he is primarily or secondarily obligated to make the payments provided in such instrument and has not attained his 66th birthday on or before the effective date of such instrument. The Insured Person will be the person named as such in such instrument if such person is eligible for insurance hereunder. In the event no person is named as the Insured Person, or if the person so named is not eligible for such insurance, then the Insured Person will be: (a) if the Buyer named in such instrument is one or more natural persons, that natural person whose signature as "Buyer" appears first; (b) if the Buyer named therein is a partnership, that natural person, being a partner, whose signature on behalf of the partnership appears first; or (c) if any Buyer named therein is a corporation, that natural person who is personally obligated on the instrument and whose signature as "Buyer" or "Co-Buyer" appears first; provided that in the event there is no natural person obligated under such instrument under the age of 66 as of the effective date thereof, all provisions with respect to such credit life insurance will be void and of no effect. Such insurance will become effective from the date the obligation of the Buyer named in such instrument is incurred and will, in the absence of default in any payment coming due thereunder, remain in force, subject to the terms of the Group Policy, until discharge of all obligations thereunder. Any amount becoming payable at the death of the Insured Person will be applied to reduce or extinguish Buyer's obligation thereunder. The amount of insurance will be the amount owing from time to time under such instrument but not to exceed $10,000 less the amount of existing insurance on the date of such instrument with respect to any other obligation for which the Buyer is insured under the said Group Policy; provided that the amount payable under the said Group Policy will be limited to a credit or refund of the amount included as the premium or cost of such insurance in such instrument in the event that death of the Insured Person results from (a) suicide, while sane or insane, within one year from the effective date of the insurance, or (b) a disease, injury or health condition for which the Insured Person was hospitalized or received medical treatment within the thirty days immediately preceding the effective date of the insurance, if death occurs within the ninety days immediately following such date. If the insurance becomes effective, a certificate of insurance describing the coverage afforded in greater detail will be furnished to the Buyer within thirty days. If the insurance is declined by the insurer or otherwise does not become effective or if a charge for an amount of insurance in excess of the foregoing limit is made, notice thereof will be sent to the Buyer and the appropriate portion of the charge for such insurance together with the finance charge applicable thereto promptly will be credited or refunded to the Buyer. In the event such insurance terminates during the lifetime of the Insured Person, the portion of the insurance charge applicable to the period subsequent to the date of termination will be refunded or credited to the Buyer. No refund or credit of insurance charge will be made if the amount thereof is less than $1.00. The insurance charge refund formula is on file with the state official having supervision of the proposed insurance and a copy thereof is on file with the group policyholder.

FL13025

THE ABOVE NOTICE APPLIES ONLY IF A CHARGE FOR CREDIT LIFE INSURANCE UNDER FORD LIFE INSURANCE COMPANY'S GROUP POLICY NO. 2200 HAS BEEN STATED IN THE ANNEXED INSTRUMENT. IF A CHARGE FOR OTHER CREDIT LIFE INSURANCE OR OTHER INSURANCE HAS BEEN INCLUDED THEREIN, BUYER WILL BE FURNISHED WITH SUCH APPLICATION, NOTICE, CERTIFICATE OR POLICY WITH RESPECT THERETO AS IS REQUIRED BY LAW.

FMCC 11712 May 76

Deft Dep. Ex. No. 10 Id.

Date: 2/2/79

Reporter: D.C.

RECEIVED
SEP 24 1980
OFFICE OF THE CLERK
SUPREME COURT, U.S.

NO. 80-84

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

-v-

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION FOR LEAVE TO PROCEED IN FORMA PAUPERIS

The respondent Olga Valencia moves for leave to proceed in forma pauperis pursuant to Supreme Court Rule 46.

The affidavit of the respondent in support of this motion is attached hereto.

Respectfully submitted,

Alan A Alop

ALAN A. ALOP

18th Street Office - Legal
Assistance Foundation of Chicago
1661 South Blue Island Avenue
Chicago, IL 60608
312/ 421-1900

NO. 80-84

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

-v-

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

A F F I D A V I T

STATE OF ILLINOIS)
) ss
COUNTY OF C O O K)

I, OLGA VALENCIA, being first duly sworn depose and say that I am the respondent in the above-entitled case; that in support of my motion to proceed in this cause without being required to prepay fees, costs or give security therefor, I state that because of my poverty, I am unable to pay the costs of said proceeding or to give security therefor, that I believe I am entitled to redress.

I further swear that the responses which I have made to the questions and instructions below relating to my ability to pay the costs of prosecuting the appeal are true.

1. Are are presently employed?

Yes. Transo-Envelope Company, 3542 North Kimball Avenue,

Chicago, Illinois. Approximately $525.00 monthly.

2. Have you received within the past twelve months any income from a business, profession or other form of self-employment, or in the form of rent payments, interests, dividends, or other source?

No.

3. Do you own any cash or checking or savings account?

Savings Account of $300.00.

4. Do you own any real estate, stocks, bonds, notes, automobiles, or other valuable property (excluding ordinary household furnishings and clothing)?

1973 Chevrolet Caprice - value approximately $500.00

5. List the persons who are dependent upon you for support and state your relationship to those persons.

Husband (unemployed) and two children.

I understand that a false statement or answer to any questions in this affidavit will subject me to penalties for perjury.

Olga A. Valencia
OLGA VALENCIA

SWORN and SUBSCRIBED to
before me this 18th day
of September, A.D., 1980.

Martha G. Alanis
NOTARY PUBLIC

NO. 80-84

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

-v-

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RULE 28.2 AFFIDAVIT

STATE OF ILLINOIS)
) ss
COUNTY OF C O O K)

ALAN A. ALOP, attorney for the respondents, being first duly sworn, deposes and states:

1. He is a member of the Bar of this Court.

2. That on September 22, 1980, he personally deposited in a United States mailbox located at the corner of Loomis and Eighteenth Streets, Chicago, Illinois, with first-class postage prepaid, ten copies of the respondents' Brief in Opposition to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit and a Motion for Leave to Proceed In Forma Pauperis.

3. That said documents were addressed to:

Office of the Clerk
Supreme Court of the United States
Washington, D.C. 20543

Alan A Alop

ALAN A. ALOP
One of the Attorneys for Petitioners

SWORN and SUBSCRIBED to
before me this 23rd day
of September, A.D., 1980.

Notary Public

NOTARY PUBLIC

CERTIFICATE OF SERVICE

The undersigned states that a copy of the foregoing and the Brief in Opposition to the Petition for Writ of Certiorari and the Motion for Leave to Proceed in forma pauperis were served upon Aaron J. Kramer, Schiff, Hardin & Waite, 7200 Sears Tower, 233 South Wacker Drive, Chicago, Illinois 60606 on this 23rd day of September, A.D., 1980 by U.S. mail.

Alan A Alop

Supreme Court, U.S.
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NO. 80-84

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

-v-

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the current Truth in Lending Act and Regulation Z require disclosure of a creditor's security interest in returned or unearned physical damage insurance premiums?

2. Whether the factors in Chevron Oil Co. v. Huson would require abandoning the general rule of retroactive application of a decision?

3. Whether a counterclaim raising substantially different issues of law and fact was properly found permissive and dismissed by the Seventh Circuit for lack of jurisdiction?

TABLE OF CONTENTS

	Page
Questions Presented	i
Table of Contents	ii-
Table of Authorities	iv-vii
Statement of Facts	1
Reasons why the Writ should Be Denied	2
1. THE DECISION BELOW WILL HAVE A LIMITED EFFECT DUE TO THE RECENT AMENDMENT OF THE TRUTH IN LENDING ACT	2
2. THE CURRENT REGULATION Z DEFINITION OF "SECURITY INTEREST" COMPELS THE FINDING THAT A CREDITOR'S INTEREST IN RETURNED OR UNEARNED PHYSICAL DAMAGE PREMIUMS IS A TILA SECURITY INTEREST	4
3. THE TENTH CIRCUIT DECISION IN JAMES V. FORD MOTOR CREDIT COMPANY IS ERRONEOUS	5
4. LIMITING THE DECISION BELOW TO PROSPECTIVE APPLICATION ONLY IS UNWARRANTED	7
A. A Decision For Respondents In This Case Was Clearly Foreshadowed	7
B. Limiting This Decision To Prospective Application Will Frustrate The Operation Of the Truth in Lending Act	9
C. No Substantial Inequitable Results Would Occur If This Decision Is Given Normal Application	9
5. UNDER THE FACTS OF THIS CASE THERE IS NO SPLIT IN THE CIRCUITS ON THE APPLICATION OF RULE 13(a) BECAUSE RESPONDENTS" TILA COMPLAINT AND FORD CREDIT'S DEBT COLLECTION COUNTERCLAIM INVOLVE DIFFERENT ISSUES OF FACT AND LAW AND ARE SUPPORTED OR REFUTED BY COMPLETELY DIFFERENT EVIDENCE. THEREFORE, THE COUNTERCLAIM IS NOT COMPULSORY AND WAS PROPERLY DISMISSED FOR LACK OF JURISDICTION	11
A. The Purpose And Test Of Rule 13(a)	11
B. The Facts Of This Case Show That There Is No Logical Relationship Between The Respondents' Complaint And Ford Credit's Counterclaim And Judicial Economy Would Not Be Served by Trying The State Law Counterclaim With The Federal Claim	12
C. When The Facts Of The Case Involving The Issue Of Compulsory Counterclaims Are Considered, There Is No Split Among The Circuits	14

Page

D. The Effect Of A State Law Issue Of First Impression In The Counterclaim 16

E. Dismissal Of The Counterclaim Is Not Unfair To Ford Credit 17

Conclusion 19

Appendix

Opinion of the Court of Appeals for Eighth Circuit (August 28, 1980) A.1

Opinion of the Court of Appeals for the Tenth Circuit (July 21, 1980) A.14

Ford Motor Credit Company form contract dated January 28, 1980 ..... A.16

TABLE OF AUTHORITIES

Cases

	Page
Basham v. Finance America, Corp., 583 F.2d 918 (7th Cir. 1978)	16
Beach v. KDI Corporation, 490 F.2d 1312 (3d Cir. 1974)	11
Brown, v. Termplan, Inc., 459 F. Supp. 160 (N.D.Ga. 1978)	9
Bulger v. Thorpe Credit Inc. of Illinois, 609 F.2d 1255 (7th Cir. 1979)	8
Carter v. Public Finance Corp., 73 F.R.D. 488 (N.D. Ala. 1977)	15
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	7-11
DeLaRama S.S. Co. v. U.S., 344 U.S. 386 (1953)	6
Edmondson v. Allen-Russell Ford., Inc., 577 F.2d 291 (5th Cir. 1978), cert. denied, 99 S.Ct. 2180 (1979)	2,4,7,8,9
Ford Motor Credit Company v. Milhollin, __U.S.__. 100 S.Ct. 790 (1980)	8
Gammons v. Domestic Loans of Winston-Salem, Inc., 423 F. Supp. 819 (M.D. N.C. 1976)	15
Gennuso v. Commercial Bank & Trust Co., 425 F. Supp. 461 (W.D. Pa. 1976), rev'd 566 F.2d 437 (3d Cir. 1977)	2,4,7,8
Great Lakes Rubber Corp. v. Herbert Cooper, Inc., 286 F.2d 631 (3rd Cir. 1961)	11
James v. Ford Motor Credit Company, No. 78-1806 (10th Cir. June 24, 1980)	2,5,6
Martin v. Commercial Securities Co., 539 F.2d 521 (5th Cir. 1976)	10
McDaniel v. Fulton National Bank, 571 F.2d 948 (5th Cir. 1978)	10
McMillen v. Blazer Financial Services, Pov. L. Rep. ¶22,720 (N.D. Ga. 1976)	15
Moore v. New York Cotton Exchange, 270 U.S. 593 (1926)	11
Murphy v. Ford Motor Credit Co., No. 79-1822 (8th Cir. August 28, 1980)	2,6,8,10

Page

Owen Equipment & Erection Co. v. Kroger, 437 U.S. 365 (1978) 11

Plant v. Blazer Financial Services, Inc. of Ga., 598 F.2d 1357 (5th Cir. 1979) 16

Railroad Commission of Texas v. Pullman, 312 U.S. 496 (1941) 17

Shanks v. Greenbriar Dodge, Inc., 577 F.2d 296 (5th Cir. 1978) 7

Southern Construction Co. v. Pickard, 371 U.S. 57 (1962) 11

Spartan Grain & Mill Co. v. Ayers, 581 F.2d 419 (5th Cir. 1978) 15,16

Travis v. Trust Company Bank, 621 F.2 148 (5th Cir. 1980) 9,10

United Mine Workers v. Gibbs, 383 U.S. 715 (1966) 17

STATUTES

1 U.S.C. §109 6

15 U.S.C. §1601 et seq. ..... passim

15 U.S.C. §1640(e) 4,9

Truth in Lending Simplification and Reform Act, P.L. 96-221, 94 Stat. 168 3

Ill.Rev.Stat. ch. 26, §2-608 1

Ill.Rev.Stat. ch. 26, §9-501 12

Ill.Rev.Stat. ch. 26, §9-504 13

Ill.Rev.Stat. ch. 26, §9-507 18

Ill.Rev.Stat. ch. 121-1/2, §571 13

Ill.Rev.Stat. ch. 121-1/2, §578 13

Rules, Regulations and Interpretations

Federal Rules of Civil Procedure, Rule 13(a) 11

12 C.F.R. §226.2(gg) 3

Revised Regulation Z, §226.2(bb), CCH Cons. Cred. Guide Report No. 304 (May 5, 1980) 3

Page

Federal Reserve Board Staff Opinion No. 377, [1969-77 Sp. Rel. Binder] Cons. Cred. Guide [CCH] Par. 30, 555 (July 22, 1970) 8

Congressional Materials

S. Rep. No. 96-73, 96th Cong. 1st Sess. 17 (1979) 3

S. Rep. No. 96-368, 96th Cong. 1st Sess. (1979) 5

Other

Wright and Miller, 6 Federal Practice and Procedure Civil 1410 (1971) 14

STATEMENT OF FACTS

The respondent Olga Valencia purchased a used 1974 Ford Pinto from Anderson Ford on September 30, 1977. Respondent Miguel Gonzalez, the brother-in-law of Olga Valencia, co-signed for this purchase. The transaction was evidenced by a retail installment contract which was simultaneously assigned to Ford Motor Credit Company ("Ford Credit"). The price of the automobile was $2340.00 plus a finance charge of $319.84. Respondent Valencia paid Anderson Ford $1000.00 downpayment, with the balance payable in 24 installments at a rate of interest of 21.40%.

Approximately three days after Valencia purchased the automobile, she returned it to Anderson Ford and requested that it repair the mechanical defects in the automobile which included, but were not limited to, defective shock absorbers and transmission problems. On or about October 13, 1977, Anderson Ford returned the automobile to Valencia. The mechanical defects in the car were still not reasonably repaired and the following day, October 14, 1977, Valencia again returned the automobile to Anderson Ford and orally revoked acceptance. On December 2, 1977, Valencia notified Anderson Ford in writing that she was revoking the acceptance of the 1974 Pinto pursuant to Ill.Rev. Stat. ch. 26, §2-608.

Despite Valencia's returning the automobile and revoking acceptance on October 14, 1977, prior to the due date of the first payment, Ford Credit took no action on the debt or the revocation until early in March of 1978 when it notified Valencia that it intended to apply for a repossession title from the Secretary of State. On March 7, 1978, the plaintiffs submitted affidavits of defense to the defendants objecting to the involuntary transfer of title and issuance

of a repossession certificate of title by the Secretary of State.[1] Ford Credit did not seek a court order to obtain title to the vehicle until June 9, 1978, three months after it received respondents' affidavits of defense. Respondents possessed the auto for a total of four days for which they paid $1000.00 which has never been returned. The Seventh Circuit affirmed the judgment for respondents on their Truth-in-Lending Act ("TILA") claim, in the amount of $1279.36 statutory damages.

REASONS WHY THE WRIT SHOULD BE DENIED

1. THE DECISION BELOW WILL HAVE A LIMITED EFFECT DUE TO THE RECENT AMENDMENT OF THE TRUTH IN LENDING ACT.

The ruling in the case below comports with the decisions of three other Circuit Courts of Appeal, holding that the current Truth in Lending Act and Regulation Z require disclosure of a creditor's security interest in returned or unearned physical damages insurance premiums. Murphy v. Ford Motor Credit Company, No. 79-1822 (8th Cir. August 28, 1980) (A. 1-13); Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978), cert. denied, 441 U.S. 951 (1979);[2] Gennuso v. Commercial Bank and Trust Co., 566 F.2d 437 (3rd Cir. 1977).[3]

1/ Throughout this litigation the respondents have consistently notified Ford Credit that having revoked acceptance of the automobile they are willing to voluntarily assign the title to Ford Credit or Anderson Ford and allow them to dispose of the automobile in any way they choose. Ford Credit, however, insists upon treating their regaining possession of the automobile as a repossession and is suing for the balance on the contract. Respondents filed the affidavit of defense solely to Ford Credit's right to obtain a repossession title.

2/ In Edmondson this Court denied certiorari to Ford Motor Credit Company, one of the petitioners in this cause, regarding the identical issue presented in the instant case.

3/ Cf. James v. Ford Motor Credit Company, No. 78-1806 (10th Cir. June 24, 1980) (rehearing denied, July 21, 1980; (A. 14-15).

On March 31, 1980, the Truth in Lending Simplification and Reform Act ("Simplification Act"). P.L. 96-221, 94 Stat. 168 (1980) was signed into law. The Simplification Act is effective April 1, 1982, and requires the Board of Governors of the Federal Reserve System to promulgate revised regulations by April 1, 1981. P.L. 96-221, Section 625.[4/]

The recent enactment of the Simplification Act and the promulgation of new rules thereunder will of necessity greatly narrow the application of the decision in this case. The amendments are designed to provide "the consumer with simpler, more understandable information . . ." and to make "compliance easier for creditors . . ." S. Rep. No. 96-73, 96th Cong. 1st Sess. 17 (1979). The petitioners argue that the Simplification Act amendments would not require the disclosure, as a security interest, of the creditor's interest in returned or unearned insurance premiums. Pet. at 12. The Seventh Circuit based its ruling on the Regulation Z definition of "security interest" in effect at the time of the pertinent credit transaction and held this disclosure required. (Pet. A. 8-12). The decision was wholly premised on the definition of "security interest" contained in Regulation Z, 12 C.F.R. §226.2(gg). Since the proposed revision of Regulation Z sets out a markedly different definition of "security interest"[5/], the effect of the ruling below will be brief; it will only govern credit transactions entered

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4/ Pursuant to this provision the Board has issued "Revised Truth in Lending Regulation Z", Cons. Credit Guide (CCH) Report No. 304 (May 5, 1980); the public comment period expired July 31, 1980.

5/ "Security interest or security means an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by and enforcible under state law." §226.2(bb) Revised Truth in Lending Regulation Z, CCH Cons. Credt. Guide Report No. 304 (May 5, 1980) (footnote omitted). Cf. Regulation Z, 12 C.F.R. §226.2(gg).

into prior to the imminent implementation of the new regulations, and less than one year ago as a result of the short TILA limitations period. 15 U.S.C. §1640(e).

The impact of the decision below on the credit industry and petitioners is slight. Even before the decision of the Seventh Circuit in this case was announced, Ford Credit had "prepared and distributed to its branch office throughout Illinois a new form of contract which conforms . . ." to the decision.[6/] Thus this decision will affect few other litigants; it will have no future effect on the petitioners or other prudent creditors who have adjusted their contract forms.[7/]

Nor is the impact of the Seventh Circuit's ruling herein severe in terms of the amount of damages. The award to the respondents below was $639.68 each, or a total of $1279.36. This extremely small damage award, when considered with the narrowly circumscribed applicability of the decision below and the limitations of this Court's resources, dictate that the petition for certiorari be denied.

2. THE CURRENT REGULATION Z DEFINITION OF "SECURITY INTEREST" COMPELS THE FINDING THAT A CREDITOR'S INTEREST IN RETURNED OR UNEARNED PHYSICAL DAMAGE INSURANCE PREMIUMS IS A TILA SECURITY INTEREST

Respondents adopt the reasoning set forth in the Seventh Circuit opinion in this cause for support of the conclusion that the failure of the petitioners to disclose the interest retained in unearned or returned insurance premiums as a security interest violates the TILA (Pet. A. 1-14).

6/ Petition for Rehearing at 8. See also A. 16-17, an example of the modified Ford Credit contract. This contract belies the argument of the petitioners that the decision below will require a lengthy disclosure that would frustrate the purposes of TILA; the new Ford Credit contract simply follows the format originally suggested in Gennuso v. Commercial Bank & Trust Co., supra, at 442, n. 17, and is actually more succinct than the form contract in this case.

7/ As noted by the court below, the petitioners could have avoided liability in the first instance by complying with the decision in Edmondson v. Allen-Russell Ford, Inc., supra: "Ford was gambling that its view of the law would prevail over the Edmondson view in subsequent suits." Valencia v. Anderson Bros. Ford, supra (Pet. A. 20).

3. THE TENTH CIRCUIT DECISION IN JAMES V. FORD MOTOR CREDIT COMPANY IS ERRONEOUS.

The decision of the Tenth Circuit in James v. Ford Motor Credit Company, supra, contradicts decisions in four other circuits and is plainly erroneous. The James opinion rests solely on the Simplification Act, an amendment to the TILA which has yet to become effective. The court ruled that the Simplification Act would not require a creditor to disclose any interest retained in unearned insurance premiums. In a per curium denial of a petition for rehearing, the court explained its ruling as being grounded on the belief that "the 1980 [Simplification] Act reflects an interpretation by Congress of the earlier [TILA] Act and is entitled to great weight." A. 15.

This is fundamentally wrong for the Truth in Lending Simplification and Reform Act, as the title confirms, represents a significant change in the law, a break with the prior legislation. The fact that the Simplification Act constitutes a major alteration of the TILA and a shift in congressional goals is clearly evidenced by the legislative history accompanying the new amendments:

> Title V simplifies and reforms truth-in-lending in four general areas: (1) it provides the consumer with simpler, more understandable information; (2) it makes compliance easier for creditors; (3) limits creditor civil liability for statutory penalties to only significant violations; and (4) it strengthens administrative restitution enforcement of the act. S. Rep. No. 96-368, 96th Cong., 1st Sess. 17 (1979).

Since the Simplification Act marks an attempt by Congress to change the current TILA, it is improper to attribute the current congressional goals and purposes to the framers of the TILA legislation which governs the 1977 transaction here under scrutiny. The legislative history indicates that Congress desired to alter the focus and requirements of the

TILA. As a consequence, the Simplification Act provides no standard for measurement of a 1977 consumer credit transaction.

Furthermore, the James decision constitutes a retroactiye application of the Simplification Act. Yet the fact that Congress intended no retroactive effect is evident in the legislation; the Simplification Act is not effective until April 1, 1982. Simplification Act, Section 625.(a). Judge Doyle dissented in James for this reason:

> Even if the [Simplification Act] legislative history would call for a different result, it should not be applied here in a retroactive way. James v. Ford Motor Credit Company, (Pet. A. 58) (dissent).

Finally, federal law specifically states that statutory amendments or repealing legislation

> shall not have the effect to release or extinguish any penalty, forfeiture, or liability incurred under such statute, unless the repealing Act shall so expressly provide, and such statute shall be treated as still remaining in force for the purpose of sustaining any proper action or prosecution for the enforcement of such penalty, forfeiture, or liability . . . 1 U.S.C. §109.

The Simplification Act does not provide for the extinguishment of liability for TILA violations occurring prior to its effective date. By virtue of 1 U.S.C. §109 then, the respondents' liability is not altered by the enactment of the TILA amendments. See DeLaRama S.S. Co. v. U.S., 344 U.S. 386 (1953).

The decision in James is premised on an erroneous view of the applicability of the Simplification Act. The Eighth Circuit, in a recent decision involving the same issue as is raised in this case, rejected the notion that the Simplification Act governs credit transactions entered into prior to its effective date. Murphy v. Ford Motor Credit Company, supra, at A. 9. In light of the erroneous conclusion of law in James and the limited applicability of the current TILA, this Court should deny the petition for certiorari.

4. LIMITING THE DECISION BELOW TO PROSPECTIVE APPLICATION ONLY IS UNWARRANTED.

Petitioners argue that this case is one in which this Court should take the highly unusual position of giving its ruling prospective application only. Prospective-only application of a judicial decision is uncommon; litigants attempting to overcome the presumption of retroactive application must satisfy the heavy burden articulated in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), which sets out three factors, all of which must be met in order to trigger solely prospective application of a decision:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding or nonretroactivity." Id. at 106-07 (citations omitted).

A. A Decision For Respondents In This Case Was Clearly Foreshadowed.

The decision below did not overrule clear past precedent; rather, it was consistent with the rulings of the Third and Fifth Circuits in Gennuso v. Commercial Bank & Trust Co., supra, and Edmondson v. Allen-Russell Ford, Inc., supra. Even at the time of the consummation of the credit transaction which underlies this controversy, two federal district courts had issued rulings consonant with the decision of the court below.[8/] Edmondson v. Allen-Russell Ford, Inc., C75-940 A (N.D. Ga.

8/ At that time only one district court had concluded that such an interest was not a TILA security interest. Shanks v. Greenbriar Dodge, Inc., Civ. No. C75-1154A (N.D. Ga. 1976), revs'd, 577 F.2d 296 (5th Cir. 1978).

April 29, 1976, aff'd, 577 F.2d 291 (5th Cir. 1978); Gennuso v. Commercial Bank & Trust Co., 425 F. Supp. 461 (W.D. Pa. 1976), revs'd on other grounds, 566 F.2d 437 (3rd Cir. 1977). Moreover, in 1970, long before the instant credit transaction, the Federal Reserve Board issued Staff Opinion No. 377, [1969-1977 Sp. Rel. Transfer Binder] Cons. Credit Guide [CCH] Par. 30, 555 (July 22, 1970) which requires creditors to disclose as a TILA security interest the interest retained in unearned insurance premiums. This staff opinion should have provided the petitioners ample guidance; under this Court's recent decision in Ford Motor Credit Company v. Milhollin, __U.S.__, 100 S.Ct. 790 (1980), the staff opinion merits the deference of this Court and "should be dispositive" of the instant case. Id. at 797.

Furthermore, petitioners' claim that the decision below upsets an industry-wide form of disclosure, Pet. at 7, 16, is erroneous. This contention is not supported by the record and is belied by Bulger v. Thorpe Credit Inc. of Illinois, 609 F.2d 1255 (7th Cir. 1979), where the facts showed that a 1976 Illinois credit transaction included a "disclosure statement [that] reveals a security interest in [H]ousehold Goods, Appliances, Furniture and all unearned credit insurance premiums' . . ." Id. at 1257. (emphasis supplied). It is thus apparent that long before the credit transaction in the instant case members of the credit industry were routinely disclosing security interests retained in insurance premiums. In fact, since Gennuso v. Commercial Bank & Trust Co., supra, Ford Credit has been virtually the only creditor continuing to litigate this issue in an effort to deny consumers this information. See Murphy v. Ford Motor Credit Company, supra; James v. Ford Motor Credit Company, supra; and Edmondson v. Allen-Russell Ford, Inc. and Ford Motor Credit Company, supra. Petitioners' contention that the decision sub judice overturns a uniform industry practice of non-disclosure is thus without merit.

B. Limiting This Decision To Prospective Application Will Frustrate The Operation Of The Truth In Lending Act

Petitioners argue that the normal application of the lower court's decision would not aid in effectuating the goals of the TILA. Yet Congress' primary objective in the TILA, the meaningful disclosure of credit terms and costs enforced through civil litigation, would be frustrated by only prospective applications of TILA decisions. It would permit creditors to omit disclosures with impunity, knowing that their past violations of the law would go unmolested. In Travis v. Trust Company Bank, 621 F.2d 148 (5th Cir. 1980), the Fifth Circuit recently rejected a creditor's attempt to have a prior TILA decision applied prospectively only pursuant to Chevron Oil; the court held that a normal retroactive application of TILA decisions would further the legislative goals of the Act. Id. at 151. See also Brown v. Termplan, Inc., 459 F. Supp. 160, 162-63 (N.D. Ga. 1978).

C. No Substantial Inequitable Results Would Occur If This Decision Is Given Normal Application.

The last factor to be considered under Chevron is whether inequity would result from retroactive application. Petitioners have not substantiated any inequitable consequences of the application of the Seventh Circuit decision. In fact, the ruling in this case reflects that the petitioners continued to use in this jurisdiction, a form contract which the Fifth Circuit expressly held to violate federal law on July 28, 1978. Edmondson v. Allen-Russell Ford, Inc., supra. (Pet. A. 20). Had Ford Credit modified its contract to conform with the Edmondson decision shortly thereafter, it would not be facing any liability whatsoever for violation of Regulation Z, except for respondents herein, in that the TILA's one year statute of limitations would have already run. 15 U.S.C. §1640(e). It is preposterous for the petitioners to perpetuate the use of an illegal disclosure form, thereby increasing

the number of consumers who have had their rights violated under the TILA, and then attempt to rely on the increased exposure to liability as a justification for this Court to exercise an equitable power of refusing to apply its decision retroactively. See Travis v. Trust Company Bank, supra at 151. The inherent inequity of this position is obvious. The Seventh Circuit concluded similarly: .

> . . . Ford was gambling that its view of the law would prevail over the Edmondson view in subsequent suits. The fact that Ford now faces the consequences of losing its conscious gamble hardly presents a case of inequitable hardship . . . The Chevron Oil doctrine is not directed at insulation of litigants from the consequences of their conscious business decisions; rather, its purpose is to avoid the hardship which can result from retroactive application of decisions which represent sudden, unexpected shifts in the law. This is not such a case. (Pet. A. 20-21).

Finally, none of the courts which have previously addressed the issue decided in this action have deemed it prudent to apply their decisions prospectively only. Petitioners rely on McDaniel v. Fulton Nat'l. Bank, 571 F.2d 948 (5th Cir. 1978) as support for a prospective application of the decision. However, McDaniel involved a situation where the Fifth Circuit in banc reversed a holding it had made less than two years before. See Martin v. Commercial Securities Co., 539 F.2d 521 (5th Cir. 1976). The court gave its new ruling only prospective application to insulate creditors who had relied on the prior decision. It is noteworthy too that the Fifth Circuit did not feel so constrained in the Edmondson decision, where its ruling that an interest in unearned insurance premiums is a security interest was not given only prospective application. See also Murphy v. Ford Motor Credit Company, supra.

As indicated above, the ruling of the court below was consistent with the overwhelming weight of prior authority, and thus did not constitute the departure from earlier authority required by Chevron Oil.

Moreover, a normal retroactive application of the decision will advance the goals of TILA without causing inequitable harm to the petitioners. Petitioners have therefore failed to satisfy the Chevron standards.

5. UNDER THE FACTS OF THIS CASE THERE IS NO SPLIT IN THE CIRCUITS ON THE APPLICATION OF RULE 13(a) BECAUSE RESPONDENTS' TILA COMPLAINT AND FORD CREDIT'S DEBT COLLECTION COUNTERCLAIM INVOLVE DIFFERENT ISSUES OF FACT AND LAW AND ARE SUPPORTED OR REFUTED BY COMPLETELY DIFFERENT EVIDENCE. THEREFORE, THE COUNTERCLAIM IS NOT COMPULSORY AND WAS PROPERLY DISMISSED FOR LACK OF JURISDICTION.

A. The Purpose And Test Of Rule 13(a).

Respondents' action is based on petitioners' violation of the TILA by failing to make required disclosures before the consummation of the contract. Ford Credit filed a counterclaim to collect sums allegedly due on the contract. The counterclaim admittedly has no independent federal jurisdictional basis and therefore, may not be asserted unless it is a compulsory counterclaim under FRCP 13(a). Beach v. KDI Corporation, 490 F.2d 1312, 1319 (3rd Cir. 1974).

The purpose of Rule 13(a) is to conserve judicial time and energy by avoiding a multiplicity of suits where the matters logically may be tried together. Southern Construction Co. v. Pickard, 371 U.S. 57, (1962). Rule 13(a) must be considered and applied in light of the "fundamental precept that federal courts are courts of limited jurisdiction," and must not be evaded. Owen Equipment & Erection Co. v. Kroger, 437 U.S. 365, 374, (1978).

In order to meet the purpose of the Rule to avoid duplicative trials and still maintain the fundamental precept of limited jurisdiction, a counterclaim will be deemed compulsory only if it has a "logical relationship" with the initial claim. Moore v. New York Cotton Exchange, 270 U.S. 593 (1926). The logical relationship test has been defined in Great Lakes Rubber Corp. v. Herbert Cooper Co., 286 F.2d 631, 634 (3d Cir. 1961) as follows:

> [A] counterclaim is logically related to the opposing party's claim where separate trials on each of their respective claims would involve a substantial duplication of effort and time by the parties and the courts. Where multiple claims involve many of the same factual issues, or the same factual and legal issues, or where they are offshoots of the same basic controversy between the parties, fairness and considerations of convenience of economy require that the counterclaimant be permitted to maintain his cause of action.

B. The Facts Of This Case Show That There Is No Logical Relationship Between The Respondents' Complaint And Ford Credit's Counterclaim And Judicial Economy Would Not Be Served By Trying The State Law Counterclaim With The Federal Claim.

A comparative analysis of the issues and evidence pertaining to the claim and counterclaim shows that they involve different issues of fact and law and are supported or refuted by completely different evidence. The counterclaim is, therefore, not compulsory.

1. Respondents' TILA Claim.

Respondents alleged a violation of the TILA because of the failure of the petitioners to properly disclose the security interest they retained in returned insurance premiums. The only fact necessary to prove this claim is the contract itself. The respondents' claim presented no contested factual issues and was decided on cross motions for summary judgment.

2. Ford Credit's Counterclaim.

In its counterclaim Ford Credit prayed for an alleged outstanding contract balance and delinquency charges of 5% of each unpaid installment as of the date of judgment. Among the issues of fact and state law presented by the counterclaim which are wholly unrelated to respondents' TILA claim are:

(a) whether the contract was properly rescinded;[9/]

(b) whether there was a default under the contract;[9/]

(c) whether Ford Credit has complied with the provisions of the Illinois Commercial Code, Ill.Rev.Stat. ch. 26, §9-501, et seq., regarding repossession and sale of the automobile.[9/]

9/ The evidence that would be submitted regarding these issues is set out in the Statement of Facts, supra.

(d) whether Miguel Gonzalez is a buyer or a guarantor of the contract;10/

(e) if Gonzales is a guarantor, whether Ford Credit has pursued all collection procedures against Valencia as required by Ill.Rev.Stat. ch. 121-1/2, §578; 10/

(f) whether Ford Credit may collect late charges on installments no longer due because of acceleration of the debt.11/

Ford Credit's counterclaim is in turn subject to counter-counterclaims by respondents, particularly an action for damages under §9-507, of the Illinois Commercial Code based upon violations of §9-504 with regard to the repossession sale. This claim was not originally pleaded

10/ Ford Credit's counterclaim is against both Olga Valencia and Miguel Gonzalez. Ms. Valencia was the purchaser of the automobile and Mr. Gonzalez, her brother-in-law, was a co-signer or guarantor. Mr. Gonzalez did not receive the automobile. Ill.Rev.Stat. ch. 121-1/2, §578, defines a co-signer as a person who does not receive the automobile in question. That section further provides that a co-signer may be held liable only if he, in addition to signing the contract, signs a separate instrument which sets out the obligations of a guarantor. Gonzalez did not sign this form and, therfore, cannot be liable. Furthermore, under §578, even had Gonzales signed the guarantor form he could not be held liable until Ford Credit has first pursued its case against Valencia; the primary obligor and the guarantor cannot be sued simultaneously in the same lawsuit. Ford Credit's counterclaim thus raises factual issues of the status of Gonzalez and the legal issue of the effect of §578 on Ford Credit's counterclaim.

11/ This raises a state law issue o first impression. Ford Credit is asking for judgment on both the accelerated balance of the debt and late charges on payment not scheduled to be made until the acceleration. Section 18 of the contract allows Ford Credit to declare the entire contractual balance to be immediately due and payable. Exercise of this acceleration clause eliminates all future payments under the contract and makes the entire balance due and payable immediately. Ford Credit accelerated the debt in early March, 1978, when it sent the respondents the notice of repossession. In the first prayer for relief in its counterclaim, Ford Credit has requested judgment for the accelerated balance. Ill.Rev.Stat. ch. 121-1/2, §571, provides that "Only one delinquency and collection charge may be collected on any installment regardless of the period during which that installment remains in default." Ford Credit's counterclaim specifically requests judgment for "delinquency charges or five per cent of each unpaid installment for each unpaid installment as of the date of judgment". The counterclaim specifically mentions installments allegedly due on April 2, May 2, and June 2, 1978, as having been unpaid and in default. Ford Credit is thus asking for late charges on installments that are due after acceleration. §571 authorizes late charges only on late payment of "installments". The act of acceleration eliminates the installment payments and prohibits the creditor from obtaining a late charge on any installment that is no longer due because of the acceleration. Even if the accelerated balance itself may be considered an "installment", only one late charge may be imposed against it (by the specific terms of §571). Thus, under this statute, at best, Ford Credit was entitled to only one late charge of $5.00 after acceleration.

by respondents because, like Ford Credit's counterclaim, it has no independent federal jurisdiction and is not subject to the Court's pendent jurisdiction.

C. When The Facts Of The Cases Involving The Issue Of Compulsory Counterclaims Are Considered, There Is No Split Among The Circuits.

Ford Credit claims there is a split in the circuits on the compulsory counterclaim issue. In making its assertion, Ford Credit looks only to the ultimate rulings that the counterclaim is compulsory or permissive. In its petition, Ford Credit totally ignores the facts set forth above and the facts of the other decisions.

In referring to the logical relationship test, one commentator has noted that "The hallmark of this approach is its flexibility. Basically, it allows the court to apply Rule 13(a) to any counterclaim that from an economy or efficiency perspective could be profitably tried with the main claim." 6 Wright and Miller, Federal Practice and Procedure, §1410, at 47 (1971). This flexible approach has been followed by the courts faced with the issue of whether a debt collection counterclaim is compulsory to a TILA claim. The determinative factors are the legal and factual issues raised by the counterclaim. Where the counterclaim raised few additional legal issues and required the proof of only a few additional facts, the counterclaim has been held compulsory. Where the counterclaim raised numerous legal issues that would have required proof of an extensive set of facts not required for determining the original TILA claim, the counterclaim has been dismissed for lack of jurisdiction. There is no irreconcilable difference in these decisions.

After considering the facts set above, the Seventh Circuit in this case affirmed the dismissal of Ford Credit's counterclaim because:

> The TILA claim and debt counterclaim raise different legal and factual issues governed by

> different bodies of law. A TILA suit for inadequate disclosure, such as the instant case, can often be resolved by an examination of the face of the loan document. A debt counterclaim, on the other hand, can raise the full range of state law contract issues. The two claims do not, as the Fifth Circuit held, spring from the same 'aggregate of operative facts'. Plant, supra, 598 F.2d at 1361. The rights and obligations of the parties with respect to the two claims hinge on different facts and different legal principles. (Pet A. 24).

Other courts that have held debt collection counterclaims to be permissive, have stressed, after considering the specific facts of the case before them, the great disparity between the legal, factual and evidentiary issues between the TILA claim and the debt collection counterclaim. See, Whigham v. Beneficial Finance Company, 599 F.2d 1322 (4th Cir. 1979); Gammons v. Domestic Loans of Winston-Salem, Inc., 423 F. Supp. 819 (M.D.N.C. 1976); and Zeltzer v. Carte Blanche Corp.; 414 F. Supp. 1221 (W.D. Pa. 1976).

Spartan Grain & Mill Co. v. Ayers, 581 F.2d 419 (5th Cir., 1978), involved the converse situation; whether a TILA counterclaim is compulsory to a debt collection claim.[12/] The Fifth Circuit held the counterclaim to be permissive because "although it arises from the contract transaction, the Truth-in-Lending Act claim involves entirely separate questions of law and fact from those dealing with the producers' liability on their accounts." 581 F.2d at 430.

Courts that have held debt collection counterclaims compulsory to a TILA action have stressed the similarity of the legal and factual issues present in those particular cases. See, Carter v. Public Finance Corp., 73 F.R.D. 488 (N.D. Ala. 1977); McMillon v. Blazer Financial Services, Pov. L. Rep. Par. 22,720 (N.D. Ga. 1976).

12/ The TILA claim was time barred unless it could be asserted as a compulsory counterclaim and relate back to the date the complaint was filed. Thus, it had no independent federal jurisdictional base.

Ford Credit claims a split in the circuits because of the decision of the Fifth Circuit in Plant v. Blazer Financial Services, Inc., of Ga., 598 F.2d 1357 (5th Cir. 1979). However, the Plant court held the debt collection counterclaim to be compulsory in that case because:

> We conclude that the obvious inter-relationship of the claims and rights of the parties, coupled with a common factual basis of the claims, demonstrates a logical relationship between the claim and counterclaim . . ." Id. at 1364

The Fifth Circuit in Plant also acted under the mistaken belief "that the vast majority of debt actions pose issues of fact and are handled on summary judgment". Id. at 1362. In the case at bar, the TILA claim was decided on summary judgment whereas an extensive trial would have been necessary for the counterclaim.

Also the court in Plant reached an erroneous conclusion of law in holding that "A determination that the underlying debt was invalid may have a material effect on the amount of damages a debtor could recover on a Truth-in-Lending claim." Id. at 1364. See, Basham v. Finance America Corp., 583 F.2d 918, 927-28 (7th Cir. 1978). In the case at bar, the fact that the automobile's sales transaction was revoked has no bearing on the amount of statutory damages provided for in the Act.

Finally, in Plant the Fifth Circuit did not overrule its prior contrary decision in Spartan Grain & Mill Co. v. Ayers, supra. Instead, the Plant court distinguished Spartan Grain by noting that the latter case "arose in a procedural setting opposite from this action". Plant v. Blazer Financial Services, Inc., supra, at 1360.

D. The Effect Of A State Law Issue of First Impression In The Counterclaim.

As noted above, Ford Credit has raised the issue of whether late charges may be imposed on installments no longer due because of accele-

ration in its counterclaim. This is a state law issue of first impression and raises significant legal issues concerning the construction of a state statute which has never been interpreted by an Illinois appellate court.

Such state law issues should not be decided by a federal court when the federal defendant could bring its entire counterclaim as an affirmative action in state court. In United Mine Workers v. Gibbs, 383 U.S. 715, (1966), this Court noted that:

> Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a sure-footed reading of applicable law. Id. at 726

Indeed, if Ford Credit's counterclaim is compulsory, the district court would have to abstain under Railroad Commission of Texas v. Pullman, 312 U.S. 496 (1941), and remand the case to the state courts for an interpretation of state law.

E. Dismissal Of The Counterclaim is Not Unfair To Ford Credit.

Ford Credit claims that dismissal of the counterclaim is unfair to it because it will have to satisfy the TILA judgment "before it can obtain a state court judgment in its favor in the amount of the unpaid loan". This contention must be rejected for several reasons.

First, from the record in this case it appears that the counterclaim was asserted by Ford Credit for purposes of delay in order to avoid prompt payment of the TILA judgment entered by the trial court. As indicated above, the respondents have several defenses to Ford Credit's counterclaim. It is unlikely that Ford Credit will ever prevail on its action. The sequence of events set forth in the record indicates that Ford Credit concurs in this result. According to the counterclaim the respondents defaulted on their contract on November 2,

1977. Ford Credit could have filed suit for the entire accelerated balance at any time thereafter. Ford Credit failed to take any action for seven months thereafter until it filed its counterclaim. During that time, on December 2, 1977, the petitioners were given written notice by Valencia that she had revoked acceptance of the car. Ford Credit thus knew at that point that the respondents were not going to make any payments on the automobile and by its calculations were now two payments in default. Still Ford Credit took no action for over six months. Under §9-507 of the Illinois Commercial Code, Ford Credit was required to act in a commercially reasonable manner and thus to quickly dispose of the collateral. Yet Ford Credit failed to act, delaying another three months before filing its present counterclaim.

From the above facts, it appears that Ford Credit had no intention of bringing suit against the respondents. However, once the respondents had filed this action Ford Credit filed its debt collection counterclaim knowing full well that extensive legal issues were present and that an evidentiary trial on the merits would be necessary. It is not the purpose of Rule 13 to allow defendants to significantly delay the final resolution of all issues in federal court.

Second, Ford Credit's argument assumes that it could obtain a judgment on its counterclaim in federal court faster than it could obtain a judgment on a separate action filed in state court. Such an assumption is unwarranted. Respondents' action was filed on May 3, 1978. Final judgment was entered in favor of the respondents on their claims over a year later on June 15, 1979. It is extremely likely that had Ford Credit filed its case in state court a final decision would have been rendered before June 15, 1979. The Circuit Court of Cook County is divided into numerous divisions; there are certain courtrooms that hear

only deficiency and contract actions. The great majority of cases assigned to those courtrooms are fully determined in less than a year.

Third, a check of the plaintiffs' index in the Municipal Department of the Circuit Court of Cook County for 1978, shows that Ford Credit filed 124 contract cases that year. The state court is thus the forum that Ford Credit regularly uses for its debt collection claims. Requiring them to file their debt collection claim in this case in state court would result in no prejudice to Ford Credit.

CONCLUSION

For the reasons stated above, this Court should deny the Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

_____

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United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 79-1822
No. 79-2061

Thaddeus S. Murphy, Appellee, v. Ford Motor Credit Co. and Hilltop Lincoln Mercury, Inc., Appellants, Thaddeus S. Murphy, Cross-Appellant, v. Ford Motor Credit Co. and Hilltop Lincoln Mercury, Inc., Cross-Appellees.	*	Appeals from The United States District Court for The Eastern District of Missouri, Eastern Division

Submitted: May 20, 1980
Filed: August 28, 1980

Before HENLEY and McMILLIAN, Circuit Judges, and ROY*, Judge.

*The Honorable Elsijane T. Roy, Judge, United States District Court for the Eastern and Western Districts of Arkansas, sitting by designation.

ROY, District Judge.

This appeal is brought by Ford Motor Credit Corporation ("Ford") and Hilltop Lincoln Mercury ("Hilltop") from a decision in the District Court[1] in favor of the plaintiff, Thaddeus Murphy ("Murphy"), on an allegation of a violation of the Consumer Credit Protection Act. This Act is known as the "Truth In Lending Act" (TILA), and is found at 15 U.S.C. §§ 1601, et seq. TILA has been translated into regulations by the Federal Reserve Board, those regulations being in the form of "Regulation Z", found at 12 C.F.R. §§ 226.1, et seq. Those portions of TILA and Regulation Z which are at issue herein are 15 U.S.C. § 1638(a)(10) and 12 C.F.R. § 226.8(a)(1)(b)(5) which relate to the disclosure of security interests created in favor of lenders.

Jurisdiction in District Court was predicated on 15 U.S.C. § 1640(e) and in this Court is based on 28 U.S.C. §§ 1291 and 1294.

In the trial court, Murphy alleged that appellants failed to disclose the identity of Ford as a creditor, failed to identify all of the property to which the security interests related, failed to disclose the right to accelerate on default, failed to put all required disclosures on the same side of the page, failed to put the required disclosures in meaningful

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[1]The Honorable Roy W. Harper, Judge, Eastern District of Missouri, Eastern Division.

sequence, and failed to provide Murphy and his co-signer with a written disclosure statement. Murphy prevailed only on the allegation that the security interest created in favor of Ford by the assignment of any returned or unearned insurance premiums was not disclosed as such security interests are required to be by the Act. Appellants brought this appeal, alleging that the assignment of the premiums did not amount to a security interest and that the District Court erred in that determination. Murphy filed a cross-appeal based on the amount of attorney's fees which was awarded, claiming that $500.00 was insufficient.

The section of the installment sales agreement which is the subject of this appeal stated, on the back of the instrument:

> The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interest of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require . . . .
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller is hereby authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of the Seller.

The District Court, relying on *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S.

951 (1979), held that the assignment of insurance premiums was a security interest as contemplated by 15 U.S.C. § 1638(a)(10) and that appellants' failure to disclose it as such constituted a violation of TILA.

The facts indicate that in March of 1978 Murphy purchased from Hilltop a 1977 Lincoln automobile. Murphy paid $1,300.00 as a down payment and financed the remainder. Murphy signed a retail installment loan contract for the amount remaining, and it was understood that the actual financing would be arranged through Ford.

Appellee filed this action against the appellants and at the close of the trial, the court found that the Act had been violated by both appellants and imposed the maximum statutory damages of $1,000.00 and awarded Murphy $500.00 for attorney's fees.

The issues presented by this appeal are, first, whether the District Court erred in its conclusion that the assignment of returned or unearned insurance premiums was a security interest which was required to be disclosed as such on the face of the contract or on the disclosure statement; and, second, whether the District Court abused its discretion in the award of attorney's fees of only $500.00 in light of the attorney's testimony that he spent 49.7 hours in preparation for and participation in the trial.

At the outset we note that three other circuit courts have determined that the assignment of unearned or returned insurance premiums in a retail installment contract does

amount to a security interest and should be disclosed as such. *Valencia & Gonzalez v. Anderson Bros. Ford, et al,* _____F.2d ____ (7th Cir. Mar. 20, 1980); *Edmondson v. Allen-Russell Ford, Inc., supra; Elzea v. National Bank of Georgia,* 570 F.2d 1248 (5th Cir. 1978); *Gennuso v. Commercial Bank & Trust Co.,* 566 F.2d 437 (3d Cir. 1977). However, the Tenth Circuit, to some extent, has held to the contrary. *James v. Ford Motor Credit Co.,* ____F.2d ____(10th Cir. June 24, 1980), and *Hernandez v. O'Neal Motors, Inc.,* ____F.2d____(10th Cir. June 24, 1980).

15 U.S.C. § 1638(a)(10) requires that the retention or acquisition of any security interest by a creditor in a consumer transaction be disclosed. However, "security interest" is not defined in TILA; rather, Congress left that detail to the Federal Reserve Board which was charged with promulgating the regulations required for the implementation of the Act. In response, the Board formulated Regulation Z. "Security interest" is defined therein at 12 C.F.R. § 226.2(gg) as follows:

> . . . any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's,materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

The appellants admit, in their brief, that the purpose of the assignment clause, or one of the purposes, is to use those returned or unearned premiums to apply to the debt of the debtor for the car. Appellants argue that the amount of such premiums would not be enough to offset any substantial portion of the debt owed on a car. Nevertheless, the definition given in the pertinent clause of Regulation Z does create an interest on the part of the creditor which secures payment or performance of an obligation. Therefore, the arguments of the appellants must fail under the clear definition of security interests.

As stated in *Valencia & Gonzales, supra*, at p. 12 of the slip opinion:

> Application of the Regulation Z definition of "security interest" in this case, as in *Edmondson*, poses no special problems. It is not seriously disputed that the assignment of unearned insurance premiums confers on the creditor an interest in property. Even the defendants refer to the assignment as an "incidental interest in property." Brief of Appellants at 8. Whether incidental or not, we agree with the Fifth Circuit that such an assignment is an interest in property. 577 F.2d at 294. Similarly, we agree that this property interest secures the performance or payment of an obligation. The assigned premiums may be used, in the sole discretion of the creditor, to purchase replacement insurance coverage or to pay part of the debtor's indebtedness. *In either case, the assignment secures an obligation of the debtor. Id.* at 294. The Creditor has the

> authority to cancel the insurance and cause payment of the unearned premiums to itself at any time. The contract clearly gives the creditor an interest in property which secures performance of a debtor's obligation. Such an interest is by definition a security interest for TILA purposes. 12 C.F.R. § 226.2(gg), and as such must be disclosed. Defendants do not suggest that such disclosure was made in the contract before us. (emphasis supplied)

Herein, the appellants concede that the assignment creates an "interest" in favor of the lender, albeit "incidental." The purpose of the assignment is to secure the payment or performance of the debtor's obligation, however small the amount of the unearned or returned premiums might be. The application of the proceeds of the insurance, whether in the form of an indemnity or returned or unearned premiums, places the assignment squarely within the definition of a security interest under Regulation Z. Undeniably, the premiums would go to secure "payment or performance of an obligation," *i.e.*, the payment of the principal and interest of the amount of the loan to the debtor.

While we recognize that state law may be a factor in determining whether a security interest has been created in a given situation, an interest may, nevertheless, be a security interest for purposes of TILA even though it is not an enforceable security interest under state commercial law. *Valencia & Gonzalex, supra; Bulger v. Thorp Credit, Inc. of Illinois*, 609 F.2d 1255 (7th Cir. 1979). Appellants argue

that the assignment does not amount to a traditional security interest. However, the Federal Reserve Board's definition of a security interest is considerably broader than the concept of security interests in the Uniform Commercial Code.

The provisions of TILA and Regulation Z, as remedial legislation, are to be broadly construed in favor of the consumer in order to implement Congressional intent and purpose. *Griffith v. Superior Ford*, 577 F.2d 455, 457 (8th Cir. 1978); *Sellers v. Wollman*, 510 F.2d 119, 122 (5th Cir. 1975). The adoption of the Act in 1968 was premised on a Congressional finding that economic stabilization and competition in the credit industry would be promoted by the informed use of credit. 15 U.S.C. § 1601. The Congressional intent was to regulate disclosure in an industry which had previously been an example of the doctrine of *caveat emptor*. "Congress has determined that such purchasers are in need of protection." *Mourning v. Family Publication Service*, 411 U.S. 356 (1973).

In support of their position, appellants have directed this Court's attention to the new Truth in Lending Simplification and Reform Act of March 31, 1980. The legislative history to this Act states:

> The security interest disclosure is also simplified to eliminate the technical disclosure of the type of security interest taken. When a security interest is being taken in property purchased as part of the credit transaction, this section requires

> a statement that a security interest has been or will be taken in the property purchased. When a security interest is being taken in property not purchased as part of the credit transaction, the Committee intends this provision to require a listing by item or type of the property securing the transaction, but not a listing of related or incidental property. For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile but would not require a listing in incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums, rights arising under or waived in accord with state law, accessions, accessories, or proceeds.
>
> Senate Committee Report, CCH Extra Edition No. 810, ¶ 2096 at 237.

However, this new Act does not take effect for two years from the date of its enactment (§ 625 of the Act), and the present action arises out of, and is controlled by, the existing Act.

We find the decisions of the Third, Fifth and Seventh Circuits to be logical and reasonable interpretations of the Act. In light of the reasoning of those decisions and the definition of "security interest" by the Federal Reserve Board, we feel compelled to resolve the issue herein in favor of the appellee.

Appellants have argued in the alternative that, if this Court affirms the District Court, the effect of the decision should be prospective, not retroactive, except as to the plaintiff.

The criteria for determining whether a decision should be given nonretroactive effect are contained in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106 (1971):

> In our cases dealing with the nonretroactivity question, we have generally considered three separate factors. First, the decision to be applied nonretroactively must establish a new principle of law, whether by overruling clear past precedent on which litigants may have relied, see, *e.g., Hanover Shoe v. United Shoe Machinery Corp., supra*, at 496, or by deciding an issue of first impression whose resolution was not clearly foreshadowed, see, *e.g., Allen v. State Board of Elections, supra*, at 572. Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." *Linkletter v. Walker, supra*, at 629. Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." *Cipriano v. City of Houma, supra*, at 706.

See, also, *Simpson v. Union Oil Co.*, 396 U.S. 13 (1969); *Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287 (8th Cir. 1975); *Shea v. City of St. Paul*, 601 F.2d 345, 350-51 (8th Cir. 1979); and *Rudolph v. Wagner Electric Corp.*, 586 F.2d 90 (8th Cir. 1978).

We have reviewed the facts at bar in light of all of the *Chevron* principles. In particular, we note that appellants have not persuaded us that retroactive application of our ruling

will impede the operation of TILA or cause undue hardship or produce inequitable results. Thus, on balance we decline at this time to limit any retroactive effect our decision may have.

In his cross-appeal, Murphy has alleged that the trial court erred in awarding only $500.00 as attorney's fees in light of the evidence offered by the attorney that he spent 49.7 hours in preparation for and in the trial of the case. Murphy contends that the award should be for $3,727.50,[2] particularly since recovery was for $1,000.00, the maximum amount which can be awarded for a single violation.

Some of the guidelines for establishing a reasonable attorney's fee award are delineated in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), and *Brown v. Bathke*, 588 F.2d 634 (8th Cir. 1978). The test to be applied on appeal in reviewing the attorney's fee award is whether the trial court abused its discretion in setting the amount of the fee. *Weeks v. Southern Bell T. & T. Co.*, 467 F.2d 95 (5th Cir. 1972), *reh. denied* 471 F.2d 650 (1973).

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[2]This is based on a charge of $75.00 per hour.

We recognize that the trial court considered many of the factors relative to the attorney's fee award in this action, but his memorandum opinion does not address the issue of whether the award was adequate to encourage enforcement of the Truth In Lending Act. The record here shows that plaintiff's attorney filed a complaint, conducted discovery by both deposition and interrogatory, then obtained leave to amend the complaint over the defendants' opposition, filed an amended complaint, submitted proposed findings of fact and conclusions of law, tried the case, and filed both trial and post-trial briefs.

Congressional goals expressed in the provisions of the Truth In Lending Act include the creation of a system of private attorneys general to aid in effective enforcement of the Act. *Soso v. Fite*, 498 F.2d 114, 121 (5th Cir. 1974); *Postow v. OBA Federal Savings & Loan Association*, ____F.2d ____ (slip opinion June 18, 1980).

Accordingly, we deem it appropriate to remand the issue of the reasonableness of the attorney's fee award to the District Court for reconsideration as to whether the award is adequate to encourage meritorious enforcement actions under the provisions of the Act.

On this appeal, Murphy shall be awarded an attorney's fee of $600.00 and also his appeal costs.

Affirmed in part and remanded in part for reconsideration of attorney's fees as indicated.

HENLEY, Circuit Judge, dissenting in part.

I find no abuse of discretion in the trial court's award of attorney's fee, and I dissent from so much of the opinion of the court as calls for remand for reconsideration of that award.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

FILED
United States Court of Appeals
Tenth Circuit

JUL 21 1980

HOWARD K. PHILLIPS
Clerk

JODY JAMES and BARBARA JAMES,

Plaintiffs-Appellants,

v.

FORD MOTOR CREDIT COMPANY and DEL NORTE MOTOR COMPANY,

Defendants-Appellees.

No. 78-1806

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(D. C. No. Civ. 78-F-647)

Before SETH, Chief Judge, BREITENSTEIN, HOLLOWAY, McWILLIAMS, BARRETT, DOYLE, McKAY, LOGAN and SEYMOUR, Circuit Judges.

PER CURIAM.

ON PETITION FOR REHEARING

The petition for rehearing is denied. The petitioners-appellants object to the consideration which the court gave to the March 31, 1980, "Trust in Lending Simplification Act" and its legislative history. The Supreme Court has said that when two acts are in pari materia, the later act can be "regarded as a legislative interpretation of the earlier." United States v. Stewart, 311 U.S. 60, 64. In Regents of the University of California v. Bakke, 438 U.S. 265, 349, the separate opinion of four Justices says: "We have repeatedly recognized that subsequent legislation reflecting an interpretation of an earlier Act is entitled to great weight in determining the meaning of the earlier statute."

The 1968 and 1980 acts related to the same subject matter, "Truth in Lending." We are convinced that the 1980 Act reflects an interpreation by Congress of the earlier act and is entitled to great weight. The effect is that Congress in passing the 1968 act did not intend to impose a civil penalty for the type of nondisclosure claimed by the appellants.

Judge Doyle would grant the petition for rehearing.

The petition for rehearing having been denied by the panel to whom the case was argued and submitted and no member of the panel nor judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

ACCT NO. _____

ILLINOIS AUTOMOBILE RETAIL INSTALLMENT CONTRACT

DATE 3/2/80

Buyer (and Co-Buyer)-Name and Address (Include County and Zip Code)

[redacted]

"Buyer" means all persons who sign this Contract as Buyer or Co-Buyer

CREDITOR
Seller-Name and Address
DEEL FORD, INC.
14800 S DIXIE HWY.
POSEN, ILLINOIS 60468

Assignee of Contract (See Assignment below): Ford Motor Credit Company, The American Road, Dearborn, Michigan 48121

The Buyer may buy the Vehicle described below for cash. The cash price is shown below in Item (1) "Cash Price". He may also buy the Vehicle on credit. The credit price is shown below in Item (10) "Deferred Payment Price". By signing this contract, the Buyer chooses to buy the Vehicle on credit under the agreements in this contract. **In this contract there is no promise as to the merchantability, suitability, or fitness for purpose of the Vehicle.** The Buyer may receive a separate warranty on the Vehicle.

New or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Vehicle Identification Number	Use For Which Purchased
NEW	1979 FORD	FIESTA	2 DOOR	4		GCFBWJ 607020	☒ Personal ☐ Agriculture ☐ Business ☐

INCLUDING:

☐ Radio ☐ Air Conditioner ☐ Automatic Transmission ☐ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☐ _____

DESCRIPTION OF TRADE-IN:

1973 CADILLAC (Year and Make) 6D49R3Q 164239 (Serial Number) $ 1016.65 (Gross Allowance) $ N/A (Amount Owing)

ADDITIONAL PROVISIONS

A. Vehicle Ownership, Use and Care: The Buyer will take care of the Vehicle and will obey all laws in using it. The Buyer will not sell the Vehicle and will keep it free from the claims of other persons. The Buyer will use the Vehicle only in the state where he now lives unless the Creditor gives him written consent to use it in another state or unless his use of the Vehicle in another state is for no more than one month.

B. Vehicle Insurance: The Buyer will insure the Buyer and the Creditor against loss or damage to the Vehicle. The type and amount of insurance must be acceptable to the Creditor. The Creditor may buy the insurance if the Buyer does not, but the Creditor does not have to do so. If the Creditor buys the insurance, the Creditor may insure only the Creditor or both the Creditor and the Buyer. In either case, the Buyer must pay back to the Creditor what the Creditor pays for the insurance plus interest at the highest rate allowed by law. If the Creditor insures only the Creditor, the Buyer will not have insurance. Whether or not the Vehicle is insured, the Buyer must pay for it if it is lost, damaged or destroyed.

If a charge for insurance is shown below, the Creditor will try to buy the coverages checked for the term shown. The Creditor is not liable though if he cannot do so. If these coverages cost more than the amount shown for insurance, the Creditor may buy them for a shorter term or he may credit the Buyer for the amount shown for insurance. If the Creditor cannot buy any insurance, he will credit the Buyer for the amount shown for insurance. The credit will be made to the last payments due. If the Creditor does not buy the insurance, the Buyer must buy it.

☐ Comprehensive
☐ Fire-Theft & Combined Additional Coverage
☐ Towing & Labor Costs ($25.00 Limit)
☐ $ N/A Deductible Collision

Term: _____ Months $ N/A

The Buyer may choose the person through whom Vehicle Insurance is to be obtained.

DETAILS OF TRANSACTION

(1) **Cash Price**		$ 5796.65 (1)
Cash Downpayment	$ N/A	
Trade-In (Description above)	$ 1016.65	
(2) **Total Downpayment**		$ 1016.65 (2)
(3) **Unpaid Balance of Cash Price** (Item (1) minus (2))		$ 4780.00 (3)
(4) **Other Charges**		
Vehicle Insurance	$ N/A	
Credit Life Insurance	$ 185.96	
Credit Disability Insurance	$ N/A	
Official Fees	$ N/A	
Taxes (Not in Cash Price)	$ 15.00	
License ($ 5.00), Title ($ N/A), and Registration ($ N/A) Fees	$ 5.00	
SERVICE POLICY	$ 235.00	
_____	$ N/A	
_____	$ N/A	
Total Other Charges		$ 440.96 (4)
(5) **Unpaid Balance – Amount Financed** (Items (3) plus (4))		$ 5220.96 (5)
(6) **FINANCE CHARGE**		$ 1931.52 (6)
(7) **ANNUAL PERCENTAGE RATE** 16.4 % (7)		
(8) **Total of Payments** (Items (5) plus (6))		$ 7152.48 (8)

(9) **Payment Schedule:** The Buyer will pay the Total of Payments (Item 8) to the Creditor in 48 monthly payments. Each payment, except the last one, will be $ 149.01. The last payment will be $ 149.01. Payments are due on the 13 day of each month. The first payment is due on 3/13/80, 19 _____.

A.16 (cont.)

Liability insurance coverage for bodily injury and property damage caused to others is not included.

C. Credit and Other Optional Insurance:

(1) Credit Life Insurance by
INT REGENTED LIFE
on the life of [redacted]

This insurance is for the term of this contract and is explained in a notice or agreement given to the Buyer on this date. $ 155.94

(2) Credit Disability Insurance by

This insurance is for the term of this contract and is explained in a notice or agreement given to the Buyer on this date. $ N/A

(3) Other Optional Insurance
(Describe and specify term)

$ N/A

$ N/A

Credit Life Insurance, Credit Disability Insurance and Other Optional Insurance is not required by the Creditor and is not a factor in the Creditor's decision to approve this credit. Credit Life Insurance or Credit Disability Insurance may be cancelled from its inception within 15 days from the date hereof by written request from each Buyer and any Guarantor. Upon cancellation, the entire charge therefor shall be refunded or credited to Buyer.

The Buyer asks the Creditor to buy the insurance for which an amount is shown above.

Buyer Date 1/28/80

(Cost of insurance to be included only if signed by each insured Buyer and dated)

(10) Deferred Payment Price (items (1) plus (4) plus (6)) $ [illegible] (10)

(11) **Security Interest:** The Buyer gives the Creditor a security interest under the Uniform Commercial Code in the Vehicle, in all money or goods received for the Vehicle and in all insurance charges financed for the Buyer. This secures the payment of the monthly payments and all other amounts the Buyer now or later owes on this contract. It also secures the Buyer's other agreements in this contract.

(12) **Prepayment Rebate:** The Buyer may pay this contract in full at any time. If he does so, he will get a credit for the unearned part of the Finance Charge if it is **$1.00** or more. This credit will be figured on the sum of the digits method after first subtracting **$25.00.**

(13) **Late Charges:** The Buyer will pay a late charge on each payment not made within **10** days after it is due. The charge is **5** per cent of the part of the payment that is late, or **$5.00,** whichever is less. The Buyer also will pay any cost paid by the Creditor to collect any late payment. The Creditor's acceptance of any late payment or late charge does not excuse the Buyer's default or mean that the Buyer can keep making payments after they are due. The Creditor may accelerate the remaining payments and repossess the Vehicle, as explained below, if there is any default.

(14) **Default:** If the Buyer fails to make any payment when it is due, or if he fails to keep any other agreement in this contract, the Creditor may do either or both of the following:

a. **Acceleration of Payments:** The Creditor may require the Buyer to pay at once all remaining payments. The Buyer will receive a prepayment rebate as explained above when he pays.

b. **Repossession:** The Creditor may repossess the Vehicle. The Creditor may also take goods found in or on the Vehicle and hold them for the Buyer. If the Vehicle is taken back, the Creditor will send a notice to the Buyer. The notice will state that the Buyer may redeem (buy back) the Vehicle. It will also show the amount needed to redeem. The Buyer may redeem the Vehicle up to the time the Creditor sells it or agrees to sell it. If the Buyer does not redeem the Vehicle, it will be sold. The money from the sale, less allowed expenses, will be used to pay the amount still owed on this contract. Allowed expenses are those paid as a direct result of having to retake the Vehicle, hold it, prepare it for sale and sell it. Lawyers' fees and legal costs are allowed too. If there is any money left (a surplus), it will be paid to the Buyer. If the money from the sale is not enough to pay off this contract and costs, the Buyer will pay what is still owed to the Creditor, if allowed by law.

(15) **General:** Any change in this contract must be in writing and signed by the Buyer and the Creditor. The law of Illinois applies to this contract. If that law does not allow all of the agreements in this contract, the ones that are not allowed will be void. The rest of this contract will still be good.

Notice to the buyer.

1. **Do not sign this agreement before you read it or if it contains any blank spaces.**
2. **You are entitled to an exact copy of the agreement you sign.**
3. **Under the law you have the right, among others, to pay in advance the full amount due and to obtain under certain conditions a partial refund of the finance charge.**

Buyer acknowledges receipt of a true and completely filled in copy of this contract at the time of signing.

RETAIL INSTALLMENT CONTRACT

Buyer Signs [redacted] (Co) Buyer Signs [redacted]

Guarantor Signs [redacted]

I hereby guarantee the collection of the above described amount upon failure of the seller named herein to collect said amount from the buyer named herein.

Assignment: The Seller accepts this contract. If no other Assignee is named at the top of this contract the Seller assigns it to Ford Motor Credit Company under the Assignment on the back of this contract. If another Assignee is named, the Seller assigns this contract to the other named Assignee under the Assignment attached to this contract. When the Assignee buys this contract, it will be the Creditor.

Seller DEER FORD, INC. By [redacted] Title FINANCE MANAGER

NOTICE – ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

FILED
OCT 3 1980
MICHAEL RODAK, JR.

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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October 3, 1980

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TABLE OF CONTENTS

	PAGE
I. There is a Direct Conflict Among the Circuits on the Security Interest Disclosure Issue which May be Resolved by Imminent Federal Reserve Board Action	2
The Legislative Intent	3
Federal Reserve Board Action	4
Impact of the Decision Below	6
II. There is a Direct Conflict Among the Circuits on the Compulsory Counterclaim Issue	8
CONCLUSION	10
SUPPLEMENTAL APPENDIX	A-1

TABLE OF AUTHORITIES

Cases

City of Cleveland v. *Cleveland Elec. Illuminating Co.*, 570 F.2d 123 (6th Cir. 1978)	9
Edmondson v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979)	2
Ford Motor Credit Company v. *Milhollin*, 444 U.S. 555 (1980)	5
Gennuso v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977)	2, 4
James v. *Ford Motor Credit Co.*, No. 78-1806 (10th Cir. June 24, 1980), *reh. denied* (10th Cir. July 21, 1980)	2, 3
Moore v. *New York Cotton Exchange*, 270 U.S. 593 (1926)	9

PAGE

Murphy v. *Ford Motor Credit Co.*, No. 79-1822 (8th Cir. August 28, 1980) 2

Plant v. *Blazer Financial Services, Inc.*, 598 F.2d 1357 (5th Cir.), *reh. denied*, 605 F.2d 555 (5th Cir. 1979) .8, 10

Regents of the University of California v. *Bakke*, 438 U.S. 265 (1978) 3

Whigham v. *Beneficial Finance Co.*, 599 F.2d 1322 (4th Cir. 1979) 8

Statutes and Congressional Materials

Consumer Credit Protection ("Truth in Lending") Act, 15 U.S.C. § 1601 *et seq.* ..... passim

Truth in Lending Simplification and Reform Act, P.L. 96-221, Title VI, 94 Stat. 168 ..... 3, 4, 6, 7

S. Rep. No. 96-368, 96th Cong., 1st Sess. (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 834 (May 1980 Supp.) 3

S. Rep. No. 96-73, 96th Cong., 1st Sess. (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 878 (May 1980 Supp.) 4

125 Cong. Rec. S.4990 (daily ed. May 1, 1979) 4

Regulation Z and Federal Reserve Board Interpretations

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980) 5

Proposed Official Staff Interpretation FC-0173 (September 18, 1980) 5, 6, 7

Rules

Rule 13(a), Federal Rules of Civil Procedure 8, 9

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Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners, ANDERSON BROS. FORD and FORD MOTOR CREDIT COMPANY ("Ford Credit"), submit this reply to bring to the Court's attention new authority from the Federal Reserve Board and to respond to certain new matters raised by respondents.

This case involves two critically important issues under the Truth in Lending Act (the "Act") on which there are clear conflicts among the Circuit Courts of Appeals. The first issue (discussed below in Point I) is whether an assignment of unearned insurance premiums needs to be disclosed as a security interest under the Act. A recently proposed Official Staff Interpretation of the Federal Reserve Board —issued after the Petition herein was filed—squarely answers that question in the negative. The second issue (discussed below in Point II) is whether a creditor's debt collection claim is a compulsory counterclaim in an action brought under the Act.

Because these issues are of great importance to the operation of the Act, and because of the severe conflict among the Circuits with respect to each, petitioners ask the Court to grant a writ of certiorari in this case to resolve both issues. Alternatively, at the very least, this cause should be remanded to the Court of Appeals for the Seventh Circuit for reconsideration of the first issue in light of the Federal Reserve Board's proposed Official Staff Interpretation which was issued after the court below had rendered its opinion. Petitioners submit, however, that these issues are ripe for resolution by this Court and that the interests of judicial economy can best be served by resolving both at this time.

I. There is a Direct Conflict Among the Circuits on the Security Interest Disclosure Issue which May be Resolved by Imminent Federal Reserve Board Action.

There is a direct and irreconcilable conflict among the Circuits over whether the assignment of unearned insurance premiums must be disclosed as a security interest under the Act. (Pet. 8-11).[1] The Tenth Circuit has ruled that the assignment of unearned insurance premiums need not be disclosed as a security interest.[2] The Fifth, Seventh, and Eighth Circuits, under a most technical reading of the Act, have ruled to the contrary in construing identical contract forms prepared by Ford Credit.[3]

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[1] The Petition for a Writ of Certiorari is cited hereafter as "Pet."; its Appendix is cited as "Pet. App." The Respondents' Brief in Opposition is cited hereafter as "Resp. Br."; its Appendix is cited as "Resp. Br. App."

[2] *James* v. *Ford Motor Credit Co.*, No. 78-1806 (10th Cir. June 24, 1980) (Pet. App. 48-58), *reh. denied* (10th Cir. July 21, 1980) (Resp. Br. App. 14-15).

[3] The opinion below; *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) (Mr. Justice White voting in favor of granting the Writ); and *Murphy* v. *Ford Motor Credit Co.*, No. 79-1822 (8th Cir. August 28, 1980) (Resp. Br. App. 1-13). *See also Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977).

The Legislative Intent

Respondents cannot and do not deny the existence of this conflict. They simply assert that the Tenth Circuit erred by applying the Truth in Lending Simplification and Reform Act[4] (the "Simplification Act") to a case involving a contract executed before the effective date of the new law. (Resp. Br. 5-6). Respondents have misconstrued the decision of the Tenth Circuit. The Tenth Circuit did not apply the Simplification Act to the pending dispute; rather, it looked to the legislative history of the Simplification Act as an aid in determining the meaning of the present Act. In denying rehearing in *James,* the Tenth Circuit noted this Court's repeated recognition that " 'subsequent legislation reflecting an interpretation of an earlier Act is entitled to great weight in determining the meaning of the earlier statute.' " *Regents of the University of California* v. *Bakke,* 438 U.S. 265, 349 (1978). (Resp. Br. App. 15). The legislative history of the Simplification Act explicitly states that the security interest disclosure requirement was intended *not* to require the disclosure of "incidental interests" such as an assignment of unearned insurance premiums.[5] After analyzing the legislative history of the Simplification Act, the Tenth Circuit concluded:

> We are convinced that the 1980 Act reflects an interpretation by Congress of the earlier act and is entitled to great weight. The effect is that Congress in passing the 1968 Act did not intend to impose a civil penalty for the type of nondisclosure claimed by the appellants. (Resp. Br. App. 15).

The Tenth Circuit's interpretation of the Act is explicitly supported by the legislative history of the Simplification Act. Senator Garn, one of the principal authors of the

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[4] Truth in Lending Simplification and Reform Act, P.L. 96-221, Title VI, 94 Stat. 168.

[5] Report of the Senate Committee on Banking, Housing and Urban Affairs, S. Rep. No. 96-368, 96th Cong., 1st Sess. 30 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 834, 864 (May 1980 Supp.).

Simplification Act, specifically indicated that the amendments merely clarified existing law:

> Many cases have resulted from the complex security interest disclosure requirements under the law. An illustrative case is *Gennuso* v. *Commercial Bank and Trust Company,* 455 F.Supp. 461 (W.D. Pa. 1976); 566 F.2d 437, (3rd Cir. 1977), which required the creditor's right in property insurance proceeds and unearned insurance premiums to be disclosed as a "security interest". *Although as presently written the law does not require that result, S. 108 should prevent such ludicrous interpretations* by requiring merely a positive indication if a security interest is being taken in the property purchased and if it is in property not being purchased in the transaction, simply a general listing of the type of property without a listing of incidental related interests. [Emphasis added.] 125 Cong. Rec. S.4990 (daily ed. May 1, 1979).

As described in the Petition for a Writ of Certiorari (Pet. 11-13), Congress was critical of the "highly technical judicial decisions" which have subverted the original purpose of the Act and have compelled creditors to issue lengthy disclosure statements "written in legalistic fine print . . . instead of the simple, concise disclosure form Congress intended."[6] Thus, the Simplification Act was enacted at least in part to correct judicial decisions that Congress believed had misinterpreted the original Act.

Federal Reserve Board Action

The Federal Reserve Board also has recently acted to resolve this question by issuing a proposed Official Staff Interpretation *under the current Act* which holds, in accordance with petitioners' position below, that the assignment of unearned insurance premiums is *not* a Truth in Lending Act security interest requiring disclosure. Pro-

[6] Report of the Senate Committee on Banking, Housing and Urban Affairs, S. Rep. No. 96-73, 96th Cong., 1st Sess. 2-3 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 878, 879-880 (May 1980 Supp.).

posed Official Staff Interpretation FC-0173 (September 18, 1980) is attached hereto as a supplemental appendix. (Supp. App. 1-4). Recognizing that its interpretation is directly contrary to several Circuit Court decisions, the Federal Reserve Board Staff stated that this interpretation better serves the purposes of the Act:

> The staff believes that *a creditor is not required* by this section [Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980)] *to disclose its right to receive insurance proceeds or unearned insurance premiums* nor to disclose that it is named as loss payee or beneficiary on an insurance policy. Truth in Lending disclosures are meant to provide useful information to consumers to enhance credit shopping. Consumers do need to know that they risk the loss of certain property if they default. The disclosures under § 226.8(b)(5) inform consumers of which property is subject to that risk at the time the credit decision is being made. We believe that information regarding the creditor's interest in insurance proceeds and unearned premiums would not be used in comparison shopping. Although a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums, it is our opinion that such incidental interests are not the type of interests meant to be covered by § 226.8(b)(5).
>
> The staff recognizes that there are a number of circuit court decisions to the contrary. We believe, however, that our position better serves the purpose of the statute and the regulation to convey in a meaningful way information that can be used by consumers in shopping for credit. [Emphasis added.] (Supp. App. 3).

The Federal Reserve Board's interpretation of the Act and Regulation Z is entitled to great deference. This Court recently stated in *Ford Motor Credit Company* v. *Milhollin*, 444 U.S. 555, 565-68 (1980):

> [D]eference [to the views of the administrative entity appointed to apply and enforce a statute] is especially appropriate in the process of interpreting the Truth in

> Lending Act and Regulation Z. Unless demonstrably irrational, *Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive* for several reasons . . .
>
> • • •
>
> The Act is best construed by those who gave it substance in promulgating regulations thereunder.
>
> Furthermore, Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth in lending law . . .
>
> • • •
>
> Finally, wholly apart from jurisprudential considerations or congressional intent, deference to the Federal Reserve is compelled by necessity; a court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views. [Emphasis added.]

Spurred by the conflicting judicial interpretations of its own Regulation Z under the current Act, the Federal Reserve Board has thus taken a dramatic step to resolve this controversy. The importance of the Board Staff's interpretation (assuming that it is adopted as proposed) is further underscored by the fact that it will represent the first occasion during the eleven year history of the Act that the Board has taken a position squarely contrary to a prior decision thereunder by a federal Court of Appeals.

Impact of the Decision Below

Respondents contend that the decision below will have little impact on the credit industry because the Simplification Act will correct the problem. (Resp. Br. 2-4). Although it is true that the security interest disclosure issue will be resolved when the Simplification Act becomes effective in 1982, or possibly at an earlier date when proposed Official Staff Interpretation FC-0173 is adopted, this Court should not ignore the staggering volume of transactions that have

been and will be subject to attack before such actions can become effective. As of the date this Petition was filed, there were 91 cases pending against Ford Credit alone (including one class action) raising the issue decided below, and thousands of additional credit transactions will be entered into before either the Simplification Act or the proposed Federal Reserve Board interpretation becomes effective. There is no reason to leave the credit industry adrift in a sea of conflicting precedents any longer. By taking this case for review, this Court can easily dispose of the security interest disclosure issue which has divided the Circuits. On the other hand, the interests of judicial economy would not be served, and the credit industry would face additional litigation and uncertainty, if this Court were to leave the resolution of this issue to future cases to be decided in the various Circuits.

Respondents also assert that this case lacks importance because Ford Credit has changed its standard form of contract. (Resp. Br. 4). Respondents fail to mention that Ford Credit has done so by eliminating—because of the dramatic exposure presented by the uncertainty of this issue in the courts—the substantive provision in the former contract by which unearned premiums on physical damage insurance were assigned to Ford Credit. The purpose of the assignment provision was to assure the continued existence of the insurance on the vehicle during the life of the loan. (Pet. 4). Without such assignment, debtors can now cancel insurance on financed vehicles in order to obtain the return of unearned insurance premiums, thereby causing lenders to lose insurance protection on the real "security" for such loans, *i.e.*, the financed vehicles themselves. Thus, the conflicting judicial decisions on this issue have had the effect—never intended by Congress—of forcing creditors to eliminate a perfectly lawful contractual provision in order to avoid the potentially enormous liability under the Act for not properly disclosing such provision.

II. There is a Direct Conflict Among the Circuits on the Compulsory Counterclaim Issue.

Respondents make the incredible argument that there is no split among the Circuits on the compulsory counterclaim issue. (Resp. Br. 14). However, the recent decisions of the Fourth, Fifth and Seventh Circuits are in direct and irreconcilable conflict on this question. In *Plant* v. *Blazer Financial Services, Inc.*, 598 F.2d 1357 (5th Cir.), *reh. denied*, 605 F.2d 555 (5th Cir. 1979), the Fifth Circuit held that a creditor's debt collection counterclaim is compulsory under Rule 13(a) in an action brought under the Truth in Lending Act arising out of the same loan transaction. The Fourth Circuit held the exact opposite in *Whigham* v. *Beneficial Finance Co.*, 599 F.2d 1322 (4th Cir. 1979). In the decision below, the Seventh Circuit expressly noted the existence of "a conflict between the Fourth and Fifth Circuits on this issue." (Pet. App. 21).

Respondents attempt to reconcile this conflict by constructing a "numerosity" test to determine whether a counterclaim is compulsory. According to respondents, a debt collection counterclaim in a Truth in Lending action sometimes is and sometimes is not compulsory, depending on the number of additional issues which it raises. (Resp. Br. 14). Respondents' argument is both ingenious and disingenuous. There is nothing in the Fifth Circuit's decision in *Plant* which suggests that its holding is limited to "simple" debt collection counterclaims, nor is there any indication in the contrary decisions of the Fourth and Seventh Circuits that their holdings are limited to debt collection counterclaims that raise numerous additional issues. The Seventh Circuit in the decision below made no attempt to distinguish *Plant* on the basis of how many new issues are presented by a counterclaim; instead, the Seventh Circuit squarely rejected, on purported public policy grounds, the Fifth Circuit's analysis. (Pet. App. 23).

Moreover, the "numerosity" test proposed by respondents is completely unworkable. Under that test, a creditor sued

by a debtor in a Truth in Lending action in federal court could not know with any degree of certainty whether he was *required* to bring his debt collection claim as a compulsory counterclaim or whether he was *forbidden* to assert such claim in federal court because the court lacked jurisdiction over it. A creditor who guessed incorrectly and filed his debt collection claim in the wrong court would, at best, incur unnecessary legal expense and, at worst, risk being barred by Rule 13(a) or by the statute of limitations from ever asserting his claim. Only a decision by this Court can resolve the conflict and dispel the uncertainty which now pervades this area of the law.

Respondents devote most of their brief to arguing the merits of their position that two separate lawsuits are required (when one would suffice) to resolve the state and federal claims arising out of exactly the same transaction. Their main argument is that the counterclaim filed herein by Ford Credit presents "issues of fact and state law . . . which are wholly unrelated to respondents' TILA claim." (Resp. Br. 12). Respondents greatly exaggerate both the number of issues raised by the counterclaim and the difficulty of such issues. The counterclaim alleges a garden-variety breach of contract, and most of the elements of that cause of action—including execution of the contract and failure to make any of the payments due under the contract—are undisputed. In effect, respondents are seeking to create a special exception to Rule 13(a) applicable to certain debt collection counterclaims brought in Truth in Lending actions. Yet, in cases brought under federal remedial statutes, such as the antitrust laws, the courts have allowed the assertion of state law counterclaims in which the elements to be proved differed from those to be proved under the federal statutes. *See, e.g., Moore* v. *New York Cotton Exchange,* 270 U.S. 593 (1926); *City of Cleveland* v. *Cleveland Elec. Illuminating Co.,* 570 F.2d 123 (6th Cir. 1978). The same result should be reached here.

In sum, Congress did not intend that defaulting debtors should have one "free shot" at their creditors under the

Truth In Lending Act. The Act does not include any prohibition against the collection of the full amount of the underlying debt or interest thereon when a disclosure violation is discovered. The court below simply adopted a public policy concerning debt collection counterclaims in Truth in Lending suits which Congress never had in mind, and it is this policy which lies at the heart of the conflict with the Fifth Circuit's decision in *Plant*. Only action by this Court can resolve this fundamental conflict.

CONCLUSION

This case presents two issues involving direct conflicts among the Circuit Courts of Appeals which are of great importance to the credit industry and to the operation of the Act. Each of these issues is ripe for resolution by this Court, and petitioners request the Court to grant the Petition for a Writ of Certiorari and resolve both issues. In the event that this Court decides not to review this case on the merits at this time, petitioners urge that the judgment below be vacated and the case remanded to the Court of Appeals for the Seventh Circuit for reconsideration in light of the Federal Reserve Board's proposed Official Staff Interpretation which was issued after the decision below had been rendered.

Respectfully submitted,

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October 3, 1980

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; FC-0173]

TRUTH IN LENDING

Proposed Official Staff Interpretation

AGENCY:

Board of Governors of the Federal Reserve System.

ACTION:

Proposed official staff interpretation.

SUMMARY:

In accordance with 12 CFR 226.1(d)(2), the Board staff is publishing for comment official staff interpretation FC-0173 of Regulation Z, Truth in Lending, regarding security interest disclosures in closed end credit transactions. The proposed interpretation holds that a creditor need not disclose as a security interest its right to receive insurance proceeds or unearned premiums nor does it need to disclose that it is named as loss payee or beneficiary on an insurance policy.

DATES:

Comments must be received on or before October 20, 1980.

ADDRESS:

Comments (including reference to FC-0173) may be mailed to Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Wash-

ington, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT:

Claudia J. Yarus, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3667).

SUPPLEMENTARY INFORMATION:

(1) The text of official staff interpretation FC-0173 is published with identifying details deleted to the extent required to prevent a clearly unwarranted invasion of personal privacy. The Board maintains and makes available for public inspection and copying a current index providing identifying information for the public, subject to certain limitations stated in 12 CFR Part 261.6.

(2) The letter is being issued as a proposal, rather than in final form, and interested persons are invited to submit relevant comment.

(3) After comments are considered, this official staff interpretation may be amended, may be withdrawn or may remain unchanged. Final action regarding this official staff interpretation will appear in the *Federal Register.*

(4) Authority: 15 U.S.C. 1640(f).

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§ 226.2(gg) Creditor is not required to disclose as a security interest its right to receive insurance proceeds or unearned insurance premiums nor to disclose that it is named as loss payee or beneficiary on an insurance policy.

§ 226.8(b)(5) " " "

This is in response to your letter requesting an official staff interpretation regarding security interest disclosures under § 226.8(b)(5) of Regulation Z. You wish to know

whether the creditor's right to receive proceeds or unearned premiums from a property or a credit life insurance policy must be disclosed as a security interest. You also ask if a security interest should be disclosed where a creditor requires that it be named as the loss payee on a property insurance policy or as the beneficiary on a credit insurance policy.

Section 226.8(b)(5) addresses disclosure of security interests in other than open end credit transactions. It requires disclosure of the type of security interest taken and identification of the property to which that interest relates.

The staff believes that a creditor is not required by this section to disclose its right to receive insurance proceeds or unearned insurance premiums nor to disclose that it is named as loss payee or beneficiary on an insurance policy. Truth in Lending disclosures are meant to provide useful information to consumers to enhance credit shopping. Consumers do need to know that they risk the loss of certain property if they default. The disclosures under § 226.8(b)(5) inform consumers of which property is subject to that risk at the time the credit decision is being made. We believe that information regarding the creditor's interest in insurance proceeds and unearned premiums would not be used in comparison shopping. Although a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums, it is our opinion that such incidental interests are not the type of interests meant to be covered by § 226.8(b)(5).

The staff recognizes that there are a number of circuit court decisions to the contrary. We believe, however, that our position better serves the purpose of the statute and the regulation to convey in a meaningful way information that can be used by consumers in shopping for credit.

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(2). It is limited to the facts and issues discussed herein.

Sincerely,

JANET HART
Director

Board of Governors of the Federal Reserve System, September 18, 1980.

(signed) THEODORE E. ALLISON
Theodore E. Allison
Secretary of the Board

[SEAL]

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE PETITIONERS

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Respondents.

QUESTIONS PRESENTED

1. Under the Truth in Lending Act and Regulation Z thereunder, is an assignment of returned or unearned insurance premiums a "security interest" requiring disclosure on the face of an automobile retail installment sales contract?

2. As the prevailing case law and industry-wide commercial usage at the time of execution of the contract form *sub judice* supported *not* disclosing the assignment of returned or unearned insurance premiums as a "security interest", should any ruling to the contrary be made prospective only?

TABLE OF CONTENTS

	PAGE
Questions Presented	i
Table of Contents	ii
Table of Authorities	v
Opinions Below	1
Jurisdiction	1
Statutes Involved	2
Statement of the Case	3
Summary of Argument	6
Argument	8
I. CONGRESS NEVER INTENDED TO REQUIRE DISCLOSURE OF AN ASSIGNMENT OF UNEARNED INSURANCE PREMIUMS	8
A. The Act And Regulation Z Do Not Expressly State Whether The Assignment Provision Is Required To Be Disclosed As A "Security Interest."	8
B. The Legislative History Of The Act Demonstrates That Congress Did Not Intend To Require Disclosure Of The Assignment Provision	10
1. The Purpose of the Act is to Facilitate Comparison Shopping for Credit by Requiring Uniform Disclosure of Credit Terms	10
2. The Security Interest Disclosure Requirement was Added to the Act in Order to Curb Abuses Relating to Second Mortgages on Borrowers' Homes	11

PAGE

3. The Act and Regulation Require Certain Insurance Information—But Not Information Relating to Unearned Insurance Premiums—to be Included in the Disclosure Statement 14

4. Disclosure of the Assignment Provision as a Security Interest Would Frustrate the Purpose of the Act 16

C. The Legislative History Of The Simplification Act Confirms That Congress Intended Not To Require Disclosure Of The Assignment Provision 19

1. Such Disclosure is Not Required under the Simplification Act 19

2. With Respect to this Issue, the Simplification Act Clarifies Existing Law 21

D. Although The Judicial Decisions On This Issue Are Sharply Divided, The Courts Which Have Looked To The Purpose Of The Act Have Held That The Assignment Provision Need Not Be Disclosed As A Security Interest 23

E. Creditors Should Not Be Subject To The Penalties Imposed By The Act For Conduct Not Clearly Proscribed In The Act .. 30

II. THE FEDERAL RESERVE BOARD DOES NOT REQUIRE DISCLOSURE OF AN ASSIGNMENT OF UNEARNED INSURANCE PREMIUMS 31

A. Great Deference Must Be Given To The Interpretations Of The Act and Regulation By The Board And Its Staff 31

PAGE

B. Proposed Official Staff Interpretation FC-0173 Expressly Holds That The Assignment Provision Need Not Be Disclosed As A Security Interest 32

III. A DECISION BY THIS COURT REQUIRING DISCLOSURE OF THE ASSIGNMENT PROVISION, UNLESS GIVEN ONLY PROSPECTIVE APPLICATION, WOULD CAUSE INJUSTICE AND HARDSHIP TO THE CONSUMER CREDIT INDUSTRY 34

A. An Adverse Decision On This Issue Was Not Clearly Foreshadowed 36

B. Retroactive Application Would Not Further The Purpose Of The Act 39

C. A Retroactive Decision Would Be Grossly Inequitable 41

CONCLUSION 44

ADDENDUM OF LEGAL AUTHORITIES ..... Add. 1

TABLE OF AUTHORITIES

Cases

	PAGE
Ancrum v. Charleston Lincoln Mercury, Inc., No. 78 804 (D.S.C. 1980)	24, 27
Bartlett v. Commercial Federal Savings and Loan Association, 433 F. Supp. 284 (D. Neb. 1977)	40
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	35, 36, 40
Ector v. Southern Discount Co., No. C78-899A (N.D. Ga. 1980)	24, 43
Edmondson v. Allen-Russell Ford, Inc., No. C75-940A (N.D. Ga. 1976), *aff'd* 577 F.2d 291 (5th Cir. 1978), *cert. denied,* 441 U.S. 951 (1979)	5, 24, 25, 27, 28, 37, 38
Ford Motor Credit Company v. Milhollin, 444 U.S. 555 (1980)	7, 9, 10, 17, 26, 28, 32, 34, 40
Gennuso v. Commercial Bank & Trust Co., 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd* 566 F.2d 437 (3d Cir. 1977)	21, 24, 27, 28, 38
Hagler v. Ford Motor Credit Co., 381 So.2d 80 (Ala. App. 1980)	24
Hare v. General Contract Purchase Corp., 249 S.W.2d 973 (Ark. 1952)	43
James v. Ford Motor Credit Company, __ F.2d __ (10th Cir. 1980)	24, 26, 27
Lemon v. Kurtzman, 411 U.S. 192 (1973)	36
Luczak v. General Motors Acceptance Corp., 494 F. Supp. 210 (W.D.N.Y. 1980)	24
McDaniel v. Fulton National Bank, 571 F.2d 948 (5th Cir. 1978)	43
Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1976)	16

	PAGE
Mourning v. Family Publications Service, Inc., 411 U.S. 356 (1973)	30, 31
Mullen v. North Pacific Bank, 610 P.2d 949 (Wash. App. 1980)	15, 24
Murphy v. Ford Motor Credit Co., 629 F.2d 556 (8th Cir. 1980)	24, 27
NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974)	22
Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969)	22
Regents of University of California v. Bakke, 438 U.S. 265 (1978)	22
Rounds v. Community National Bank, 454 F.Supp. 883 (S.D. Ill. 1978)	13, 24, 25, 38
Sanders v. Auto Associates, Inc., 450 F.Supp. 900 (D.S.C. 1978)	42
Seatrain Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572 (1980)	22
Shanks v. Greenbriar Dodge, Inc., Civ. No. C75-1154A (N.D. Ga. 1967), *rev'd*, 577 F.2d 296 (5th Cir. 1978)	15, 25, 38
Sneed v. Beneficial Finance Co., 410 F.Supp. 1135 (D. Hawaii 1976)	43
Souife v. First National Bank of Commerce, 628 F.2d 480 (5th Cir. 1980)	24, 28, 29, 30
Udall v. Tallman, 380 U.S. 1 (1965)	31
United States v. Larionoff, 431 U.S. 864 (1977)	31
Zenith Radio Corp. v. United States, 437 U.S. 443 (1978)	31

PAGE

Statutes

Consumer Credit Protection Act, 15 U.S.C. § 1601 et seq. ..... passim
Section 102(a), 15 U.S.C. § 1601(a) 10, 39
Section 106(c), 15 U.S.C. § 1605(c) 15
Section 113, 15 U.S.C. § 1612 30
Section 128(a)(10), 15 U.S.C. § 1638(a)(10) 2, 8, 12, 13
Section 130(a), 15 U.S.C. § 1640(a) 30

Judicial Code, 28 U.S.C. § 1254(1) 2

Truth in Lending Simplification and Reform Act, P.L. 96-221, Title VI, 94 Stat. 168 ..... passim

Regulation Z and Federal Reserve Board Interpretations

Regulation Z, 12 C.F.R. § 226.2(gg) (1980) 2, 8, 32

Regulation Z, 12 C.F.R. § 226.6(c) (1980) 40

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980) 2, 32, 33

Federal Reserve Board Official Interpretation, 12 C.F.R. § 226.403 (1980) 15

Federal Reserve Board staff letter, [1969-74 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 30,261 (Jan. 9, 1970) 34

Federal Reserve Board staff letter, [1969-74 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 30,596 (Oct. 22, 1970) 34

Federal Reserve Board Staff Opinion No. 1066, [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,406 (June 4, 1976) 12

Proposed Official Staff Interpretation FC-0173, 45 Fed. Reg. 63295 (Sept. 24, 1980) 18, 32, 33, 34, 40

Proposed Official Staff Interpretation FC-0173, Deferral of Final Action, 45 Fed. Reg. 84074 (Dec. 22, 1980) 34

PAGE

Proposed Revision of Regulation Z, 45 Fed. Reg. 80647 (Dec. 5, 1980) 17, 20, 21, 22, 23

Congressional Materials

114 Cong. Rec. 1610-11 (1968) 11, 12

114 Cong. Rec. 5024 (1968) 12

125 Cong. Rec. S.4990 (daily ed. May 1, 1979) 21, 28

H.R. Rep. No. 1040, 90th Cong., 1st Sess. (1967), *reprinted in* [1968] U.S. Code Cong. & Ad. News 1962 10

S. Rep. No. 392, 90th Cong., 1st Sess. (1967) 10

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Other

F. Beytagh, *Ten Years of Non-Retroactivity: A Critique and a Proposal,* 61 Va. L. Rev. 1557 (1975) ... 35

B. Cardozo, *The Nature of the Judicial Process,* 146 (1921) 35

T. Fairchild, *Limitation of New Judge—Made Law to Prospective Effect Only: "Prospective Overruling" or "Sunbursting",* 51 Marq. L. Rev. 254 (1967-68).. 35

66 Federal Reserve Bulletin A40 (Table 1.56) (1980) 42

J. Landers, *Some Reflections on Truth in Lending,* 1977 U. Ill. L.F. 669 18

W. Schaefer, *The Control of "Sunbursts": Techniques of Prospective Overruling,* 42 NYU L. Rev. 631 (1967) 35

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Respondents.

BRIEF OF THE PETITIONERS

OPINIONS BELOW

The opinion of the Court of Appeals (J.A. 38-64) is reported at 617 F.2d 1278. The opinions of the District Court (J.A. 9-21, 33-35) are not reported.

JURISDICTION

The Judgment of the United States Court of Appeals for the Seventh Circuit was entered on March 20, 1980. The order denying Defendants' timely Petition for Rehearing was entered on April 22, 1980 (J.A. 66). The Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit was timely filed on July 19, 1980. On November 10, 1980, this Court granted the Petition for a Writ of Certiorari limited to questions one and two presented by the Petition.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statute and regulations involved in this case are: Consumer Credit Protection Act, § 128(a)(10), 15 U.S.C. § 1638(a)(10):

> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> • • • •
>
> (10) A description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

Regulation Z, 12 C.F.R. § 226.2(gg) (1980):

> "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980):

> (b) *Disclosures in sale and nonsale credit.* In any transaction subject to this section, the following items, as applicable, shall be disclosed:
>
> • • • •
>
> (5) A description or identification of the type of any security interest held or to be retained or acquired by

the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

STATEMENT OF THE CASE

On September 30, 1977, Olga Valencia and Miguel Gonzalez (the "Buyers") purchased a used 1974 Ford Pinto from Anderson Bros. Ford pursuant to an Illinois Automobile Retail Installment Contract (the "Contract"), a full-sized copy of which is attached at the end of the Joint Appendix. The Contract was subsequently assigned for value by Anderson Bros. Ford to Ford Motor Credit Company.[1]

As required by the Truth in Lending Act (the "Act"), 15 U.S.C. § 1601 *et seq.*, the face of the Contract (which is

[1] For ease of reference, Anderson Bros. Ford and Ford Motor Credit Company hereinafter will be referred to jointly as "Ford Credit".

the "disclosure statement" under the Act) contained certain disclosures. In paragraph 12, the Contract disclosed the security interest acquired by Ford Credit as follows:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

In paragraph 17 on the reverse side of the Contract,[2] captioned "RISK OF LOSS—INSURANCE," the Contract required the buyer to purchase and maintain in force physical damage insurance on the vehicle. Paragraph 17 also provided:

> *Buyer hereby assigns to Seller any monies payable under such [physical damage] insurance, by whomever obtained, including returned or unearned premiums,* and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller. [Emphasis added.]

Under the assignment provision in the Contract italicized above, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt. The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed

---

[2] Although this paragraph is not numbered, it is referred to herein as "paragraph 17" since it comes between paragraph 16 and paragraph 18.

vehicles, thereby exposing lenders to the risk of uninsured collateral.

On May 3, 1978, the Buyers filed a two-count Complaint (J.A. 2-6) which alleged that Ford Credit violated the Truth in Lending Act and a similar Illinois statute because the Contract allegedly failed, *inter alia,* to disclose a security interest in returned or unearned physical damage insurance premiums (hereafter "unearned insurance premiums").

By an opinion issued on October 31, 1978, the District Court dismissed the Complaint in this action in its entirety for failing to state any claim for which relief could be granted. (J.A. 9-18). With respect to the assignment of unearned insurance premiums, the District Court reasoned:

> The assignment of unearned insurance premiums is not a security interest in the normal meaning of that term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents. (J.A. 11).

On November 17, 1978, the District Court issued a Supplemental Decision (J.A. 19-21) reinstating that portion of the Complaint which alleged that the assignment of unearned insurance premiums is a "security interest." The District Court based this reversal of its initial ruling on the decision in *Edmondson* v. *Allen-Russell Ford, Inc.,* 577 F.2d 291 (5th Cir. 1978), *cert. denied,* 441 U.S. 951 (1979). Thereafter, in a June 5, 1979 decision (J.A. 33-35) and an order entered on June 15, 1979 (J.A. 36-37), the District Court awarded summary judgment for Buyers holding that the assignment of unearned insurance premiums is a "security interest" that must be disclosed under the Act and Regulation Z.

On March 20, 1980, the United States Court of Appeals for the Seventh Circuit rendered the opinion (J.A. 38-64) as to which the writ of certiorari herein was granted, affirming the District Court's judgment of June 15, 1979. Judge Sprecher's opinion was accompanied by two expressly "reluctant" concurring opinions by Judges Cudahy and Swygert (J.A. 63-64) which noted in pertinent part that:

—the assignment provision at issue was "entirely incidental to the principal consumer credit transaction";

—requiring such a provision to be disclosed as a "security interest" on the face of the contract could not be taken as seriously suggesting a furtherance of the underlying purposes of the Truth in Lending Act;

—the opinion requires "the prominent disclosure of a rather esoteric right" which if disclosed as a "security interest" merely "add[s] virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit"; and

—"the important ends of credit disclosure . . . [might] be obscured in a whirl of litigious gamesmanship" following the opinion.

SUMMARY OF ARGUMENT

The Act and Regulation Z require that "security interests" be disclosed on the front of retail installment contracts. The Regulation defines "security interest" but does not expressly provide whether the assignment provision at issue here constitutes such an interest. Therefore, it becomes necessary to turn to other sources in order to ascertain whether Congress intended to require disclosure of such provision.

The legislative history demonstrates that Congress did not intend to require disclosure of the assignment provision.

The purpose of the Act is to facilitate comparison shopping for credit by requiring uniform disclosure of credit terms, primarily those pertaining to the cost of credit. The security interest disclosure requirement was added to the Act so that a borrower would be informed of an essential term of the credit transaction—that his home was subject to a second mortgage. The rationale of that requirement does not extend to disclosure of the assignment provision which involves an incidental and ephemeral interest and does not affect the borrower's decision-making process in shopping for credit. Indeed, to require prominent disclosure of the assignment provision would tend to defeat the purpose of the Act by detracting from the credit cost disclosures which are of much greater importance to the borrower.

Enactment of the Truth in Lending Simplification and Reform Act (the "Simplification Act") on March 31, 1980 provides additional support for this conclusion. The legislative history of the Simplification Act expressly states that the disclosure of "incidental interests" such as an assignment of unearned insurance premiums is not required. With respect to this issue, the Simplification Act clarified existing law in order to correct overly technical judicial decisions that Congress believed had misinterpreted the original Act.

In *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), this Court last term emphasized that great deference must be given to the interpretation of the Act and Regulation by the Federal Reserve Board (the "Board") and its staff. The Federal Reserve staff has recently issued a proposed Official Staff Interpretation under the present Act which holds that the assignment of unearned insurance premiums is not a security interest requiring disclosure.

If this Court were to rule that the assignment provision must be disclosed as a security interest, such ruling would establish a new principle of law and should be given pro-

spective application only (except as to the Buyers). There are millions of automobile credit contracts outstanding in the United States today, most of which contain an assignment of unearned insurance premiums on the reverse side. Retroactive application of an adverse ruling by this Court would thus lead to the imposition of staggering liability on consumer credit companies and banks without in any way furthering the purpose of the Act.

ARGUMENT

I. CONGRESS NEVER INTENDED TO REQUIRE DISCLOSURE OF AN ASSIGNMENT OF UNEARNED INSURANCE PREMIUMS.

A. The Act And Regulaton Z Do Not Expressly State Whether The Assignment Provision Is Required To Be Disclosed As A "Security Interest."

The Act requires "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates." 15 U.S.C. § 1638(a)(10). The Act does not define the term "security interest." Regulation Z, 12 C.F.R. § 226.2(gg) (1980), provides that "security interest" means "any interest in property which secures payment or performance of an obligation." The Regulation also lists some examples of security interests required to be disclosed:

> security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

The Regulation thus does not expressly cover the assignment provision at issue here.[3] The language of the Regulation, however, does make it clear that the Regulation focuses on security interests the function of which is to secure the debt—and not on interests in property which are incidental to the consumer transaction. Read with deference to the principle of *ejusdem generis*, Regulation Z would appear to halt the Act's disclosure requirement well short of the sort of incidental interest in property at issue here.

This case thus presents a situation similar to that recently considered by this Court in *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980). In *Milhollin*, the issue for decision was whether the Act required that the existence of an acceleration clause be disclosed on the face of a credit agreement. The Court first examined the express language of the Act and Regulation Z and concluded that the acceleration issue was "not governed by clear expression in the statute or regulation." *Id.* at 560.

As the Court noted,

> legislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of legislative or regulatory silence.

Id. at 565.

The express language of the Act and Regulation does not resolve the question of whether an assignment of unearned

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[3] As discussed below in Part II, the staff of the Board has taken the position that a creditor's right to unearned insurance premiums need *not* be disclosed as a security interest under the Act and Regulation.

insurance premiums must be disclosed as a security interest on the face of an installment credit contract. Therefore, as in *Milhollin,* "it becomes necessary to consider the implicit character of the statutory scheme." *Id.* at 560.

B. The Legislative History Of The Act Demonstrates That Congress Did Not Intend To Require Disclosure Of The Assignment Provision.

1. The Purpose of the Act is to Facilitate Comparison Shopping for Credit by Requiring Uniform Disclosure of Credit Terms.

The purpose of the Act is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit. . . ." 15 U.S.C. § 1601(a). As was made clear in the legislative history of the Act, the primary emphasis was on assuring the disclosure of the *cost of credit* in uniform terms:

> The basic purpose of the truth in lending bill is to provide a full disclosure of *credit charges* to the American consumer . . . .
>
> By providing full and comparable disclosure information, the bill will permit consumers to compare the *cost of credit* among different creditors and to shop effectively for the best credit buy. The committee also believes that the bill will promote the wiser use of consumer credit by consumers when they know the full *cost of credit.* [Emphasis added.]

Report of the Senate Committee on Banking and Currency to accompany S. 5, S.Rep. No. 392, 90th Cong., 1st Sess. 1 (1967). *Accord,* Report of the House Committee on Banking and Currency to accompany H.R. 11601, H.R. Rep. No. 1040, 90th Cong., 1st Sess. 6-7 (1967), *reprinted in* [1968] U.S. Code Cong. & Ad. News 1962, 1962-63.

2. The Security Interest Disclosure Requirement was Added to the Act in Order to Curb Abuses Relating to Second Mortgages on Borrowers' Homes.

Neither the 1967 Senate bill nor the 1967 House bill made any reference to the disclosure of security interests taken in connection with consumer credit transactions. The provision of the Act relating to security interest disclosure was proposed as an amendment from the floor of the House of Representatives by Congressman Cahill of New Jersey. 114 Cong. Rec. 1610 (1968). That amendment was one of four amendments offered by Mr. Cahill for the purpose of curbing perceived abuses and deceptive practices in connection with consumer loans secured by second mortgages.[4]

Mr. Cahill stated that his amendments were designed to strengthen the bill then before the House with respect to mortgage lending abuses:

> [D]espite the general comprehensiveness of this legislation, in my judgment there are serious and important omissions which should be corrected. These omissions relate primarily to consumer credit extended on the security of mortgages and liens on homes and residences. I am sure that most of the Members are aware of the extent to which vicious secondary mortgage schemes have victimized homeowners. . . .
>
> • • • •
>
> I have, therefore, offered these four amendments designed to improve the truth-in-lending provisions with respect to mortgage transactions.

[4] The other amendments offered by Congressman Cahill were intended to extend the disclosure requirements of the Act to mortgage brokers and others who arrange credit transactions; to permit actions to be brought against assignees of mortgages in certain circumstances; and to provide that a borrower whose residence is put up as security shall receive the required disclosures at least three days before the transaction is consummated. 114 Cong. Rec. 1610-11 (1968).

114 Cong. Rec. 1611 (1968). With respect to security interest disclosure, Mr. Cahill explained that there was a need to require creditors to disclose security interests acquired in connection with a consumer credit transaction in order to avoid situations in which the homeowner "is never informed nor aware that his *home* is being made *subject to a mortgage.*" *Id.* (Emphasis added.) Mr. Cahill summarized the intended effect of his amendment by stating that it "would require that there be disclosure that a *mortgage* is being placed *on the borrower's home* and that the consequences of such a mortgage can be explained." *Id.* (Emphasis added.)

Mr. Cahill's amendments were adopted without objection by the House. 114 Cong. Rec. 1610-11 (1968). Senator Proxmire, in bringing the amendments to the attention of the Senate, described the security interest disclosure requirement as follows:

> Congressman Cahill, of New Jersey, has offered an important amendment to the truth-in-lending bill which tightens up on the *second mortgage racket*. . . . Second, it would require a disclosure of the fact that credit is being secured by a *mortgage* on the homeowner's property. . . . [Emphasis added.]

114 Cong. Rec. 5024 (1968). With no further discussion of the security interest disclosure requirement, the provision was incorporated into the final version of the Act and adopted into law as 15 U.S.C. § 1638(a)(10).

The security interest disclosure requirement thus was designed to prevent certain deceptive practices in credit transactions in which a borrower takes out a second mortgage on his home to secure the loan. The purpose of the disclosure is to inform a borrower that his property is serving as security for the loan and thus is at risk should he fail to repay the loan. Federal Reserve Board Staff Opinion No. 1066, [1974-77 Special Releases Transfer Binder]

CONS. CRED. GUIDE (CCH) ¶ 31,406 (June 4, 1976). Congress determined that a consumer, in order to comparison shop for the best credit terms, should be told whether or not a lender would require him to put his home at risk. It therefore required that lenders disclose, on the face of the contract, this essential term.

In the transaction in the instant case, the automobile purchased by the Buyers is analogous to a home subject to a second mortgage; it served to secure the extension of credit and was at risk if the Buyers failed to make the required monthly payments. Therefore, the fact that Ford Credit retained a security interest in the automobile had to be (and was) disclosed to the Buyers pursuant to 15 U.S.C. § 1638(a)(10). But it would stretch the rationale of that section beyond the breaking point to hold that an assignment of unearned insurance premiums is analogous to a home mortgage. The right to receive unearned insurance premiums is hardly an essential term, and it is wholly unrelated to the borrower's ability to repay the underlying debt. The very existence of the unearned premiums depends upon the cancellation of the insurance coverage, a decision unrelated to, and not necessarily triggered by, a default in payment of the debt.

Moreover, from the moment of issuance of physical damage insurance which names the lender as a loss payee, the property interests in the policy are at least joint, and in fact belong more to the lender than the debtor as long as the debt remains unpaid. In *Rounds* v. *Community National Bank,* 454 F. Supp. 883, 888 (S.D. Ill. 1978), the court observed:

> Both the assignment of unearned premiums and the assignment of insurance proceeds do provide some benefit and protection to the lender. But neither of

> those provisions subject the debtor's property to any lien or any risk. Rather, the insurance provisions of the agreement are properly construed as being mutually protective of the interests of both the debtor and the creditor.

Disclosure of the assignment of unearned insurance premiums as a security interest simply would not serve the purpose for which such disclosures are required by the Act—to let the borrower know what property belonging to him will be reachable on default.

3. The Act and Regulation Require Certain Insurance Information—But Not Information Relating to Unearned Insurance Premiums—to be Included in the Disclosure Statement.

Before adopting the Act, Congress carefully considered what information regarding insurance aspects of credit transactions ought to be included in Truth in Lending disclosure statements. The primary issue facing Congress in this area was whether premiums paid by consumers for various types of insurance should be included in the "finance charge" stated in the disclosure statement. With respect to property damage insurance on property securing the debt, Congress determined to permit creditors to exclude the premiums from the finance charge, but only if the debtor was clearly informed of his right to choose where to buy the insurance:

> Charges or premiums for insurance, written in connection with any consumer credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property, shall be included in the finance charge unless a clear and specific statement in writing is furnished by the creditor to the person to whom the credit is extended, setting forth the cost of the insurance if obtained from or through the creditor, and stating that the person to whom the

> credit is extended may choose the person through which the insurance is to be obtained.[5]

15 U.S.C. § 1605(c). *See also* 12 C.F.R. § 226.403.

The statutory scheme with respect to property damage insurance disclosures is clearly relevant in ascertaining Congressional intent with respect to disclosure of unearned premiums on such insurance. In *Shanks* v. *Greenbriar Dodge, Inc.*, No. (75-1154A) (N.D. Ga. 1976),[6] *rev'd* 577 F.2d 296 (5th Cir. 1978), the district court found that Congress did not require even the total cost of property damage insurance premiums to be itemized, disclosed or included in the finance charge. Therefore, the court reasoned, it makes little sense to interpret the Act as requiring that the assignment of unearned insurance premiums be disclosed:

> Congress and the Board have given considerable study to the cost of insurance incident to the obtaining of credit and have specifically set out those disclosures which it was felt effectuated the policy of the Act. As both bodies have thoroughly considered the insurance premium issue and have not required the disclosure sought here, then this Court should not.

Moreover, even the fact that the borrower is required to maintain property damage insurance need not be included in the disclosure statement. *Mullen* v. *North Pacific Bank*, 610 P.2d 949, 954 (Wash. App. 1980).

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[5] For example, Ford Credit's form of contract contains the following statement on the front side, about half-way down the left column:

> NOTICE TO BUYER: . . . (2) You have the right to choose the person through whom the Physical Damage Insurance required under this contract is to be obtained.

[6] The district court's unreported opinion in *Shanks* is reproduced in the Addendum of Legal Authorities ("Add.") attached to this brief, at Add. 40-52.

Thus, in deciding to focus the Act's disclosure requirements on the cost and essential terms of credit, Congress concluded that the cost of property damage insurance premiums need not always be included in the disclosure statement. Indeed, even the fact that the borrower is required to maintain such insurance need not be so disclosed. Yet, an assignment of the unearned portion of property damage insurance premiums is clearly of less importance to a borrower than the total cost of such insurance premiums or the fact that such insurance is required as part of the transaction. In most circumstances, the unearned portion of the insurance premiums will be substantially smaller than the total cost since the premiums will be earned during the time that the insurance coverage remains in force. Further, unearned insurance premiums will be rebated only in the distinct minority of cases in which the insurance coverage is cancelled before the end of the period for which the premiums were paid. Therefore, since Congress determined that it was not necessary to include in the disclosure statement the fact that the borrower is required to maintain property damage insurance or always to include the total cost of such insurance premiums, it is most unlikely that Congress intended to require that the less important assignment of unearned insurance premiums be so disclosed.

4. Disclosure of the Assignment Provision as a Security Interest Would Frustrate the Purpose of the Act.

The contracts used in these transactions already contain so much information that Judge Moore, dissenting in *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 888 (7th Cir. 1976), noted that if the entire contract were printed on only one side, it would be "an unwieldy document of some 30 inches in length—not unlike an ancient Egyptian papyrus scroll." Requiring too much detail to be

included in disclosure statements can thus defeat the purpose of the Act because the disclosure statements become unreadable. As this Court recognized in *Milhollin*:

> The concept of "meaningful disclosure" that animates TILA [citation omitted] cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between "competing considerations of complete disclosure . . . and the need to avoid . . . [information overload]." [Citations omitted.]

444 U.S. at 568. The Board, in explaining its recently proposed revision of Regulation Z, similarly observed that the "impact and utility" of disclosure statements are "diluted" to the extent that essential information is accompanied by "complex disclosure of less significant terms." 45 Fed. Reg. 80647, 80648 (Dec. 5, 1980).

Application of these principles to the issue in this case demonstrates that the decision below is likely to frustrate the purpose of the Act. Requiring disclosure of the assignment provision (as well as a listing of all other incidental interests in property which a lender may acquire in a credit transaction) to be added to the straightforward language in paragraph 12 on the front of the Contract would only distract the debtor from the important fact that the financed automobile (the *real* "security") and the proceeds therefrom were at risk if he failed to make the periodic payments due under the Contract. The fact that the debtor assigned unearned insurance premiums, if any,[7] to the lender, to be

[7] In the vast preponderance of cases, unearned premiums are never collected by the creditor because they are earned during the life of the installment contract and the coterminous physical damage insurance policy. In the case at bar, there were no unearned insurance premiums since the Buyers never paid any premiums. (Rec. Doc. No. 33 at 46).

applied by the lender either to replace the insurance or to pay down the debtor's loan obligation is of virtually no consequence to the debtor. It does not place his property at risk, and giving it the same dignity of disclosure as a security interest can only result in confusion.

Moreover, inclusion of the assignment provision on the front side of credit contracts would not aid consumers in shopping for credit. With respect to the precise question at issue here, the Federal Reserve staff recently published a proposed interpretation which stated (Add. 56):

> Truth in Lending disclosures are meant to provide useful information to consumers to enhance credit shopping. . . . We believe that information regarding the creditor's interest in insurance proceeds and unearned premiums would not be used in comparison shopping.

Proposed Official Staff Interpretation FC-0173 (Add. 54-57), 45 Fed. Reg. 63295 (Sept. 24, 1980).

Professor Jonathan Landers explained why such technical contract terms are not considered by consumers in their decision-making process:

> [T]he technical terms of the contract tend to be relatively standardized and do not lend themselves to either comparison shopping or effective bargaining. This is because the economic effect of the technical terms is small and consumers who do compare may be expected to shop or bargain on the key cost items—the finance charge and the APR [annual percentage rate]—and not on a variety of subsidiary terms.

J. Landers, *Some Reflections on Truth in Lending*, 1977 U. Ill. L.F. 669, 685. Therefore, to require prominent disclosure of the insignificant assignment provision at issue here would not further the purpose of the Act by facilitating comparison shopping for credit. Rather, such requirement would tend to defeat the purpose of the Act by detracting

from the credit cost disclosures which are of much greater importance to the consumer.

C. The Legislative History Of The Simplification Act Confirms That Congress Intended Not To Require Disclosure Of The Assignment Provision.

1. Such Disclosure is Not Required under the Simplification Act.

As noted above, Congress intended the Act to promote "meaningful disclosure of credit terms." However, in recent years Congress became concerned that overly technical judicial decisions were defeating that purpose by requiring too much complexity in disclosure statements. This concern was expressed in the Report of the Senate Committee on Banking, Housing and Urban Affairs, S. Rep. No. 96-73, 96th Cong., 1st Sess. 2 (1979), *reprinted in* [1980] U.S. Code Cong. & Ad. News 878, 879 (May 1980 Supp.):

> There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as *highly technical judicial decisions.* [Emphasis added.]

Because of such decisions, creditors had felt compelled to issue lengthy disclosure statements "written in legalistic fine print . . . instead of the simple, concise disclosure form Congress intended." *Id.* at 3, [1980] U.S. Code Cong. & Ad. News at 879-80.

In response to these concerns, the Simplification Act was adopted and signed into law on March 31, 1980 as Title VI of P.L. 96-221, 94 Stat. 132, 168. Under Section 614(a)(9) of the Simplification Act, 94 Stat. 179, where the credit is secured, the creditor shall disclose "a statement that a secu-

rity interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

The legislative history makes it clear that the disclosure of "incidental interests," such as an assignment of unearned insurance premiums, is *not* required:

> When a security interest is being taken in property not purchased as part of the credit transaction, the Committee intends this provision to require a listing by item or type of the property securing the transaction, *but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile *but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums,* rights arising under, or waived in accord with state law, accessions, accessories, or proceeds. [Emphasis added.]

S. Rep. No. 96-368, 96th Cong., 1st Sess. 30 (1979), *reprinted in* [1980] U.S. Code Cong. & Ad. News 834, 864 (May 1980 Supp.).

The Simplification Act, which becomes effective on April 1, 1982, requires the Board to have implementing regulations in place by April 1, 1981. 94 Stat. 185. The Board recently issued a proposed revision of Regulation Z in response to that mandate. 45 Fed. Reg. 80647 (Dec. 5, 1980). The term "security interest" is defined in the proposed revision to mean

> an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by or enforceable under state or federal law. *It does not include incidental interests such as* an interest

> in proceeds, assessions, additions, fixtures, *insurance proceeds or premium rebates* . . . . [Emphasis added.]

Id. at 80696. The Board noted that this definition is intended to implement the Congressional intent, evidenced by the language quoted above from the Senate Report, to restrict security interest disclosure to a simple but meaningful concept. *Id.* at 80655. The Board also observed that this definition "explicitly excludes from coverage many incidental interests in property that have been found to be security interests by various courts in the past." *Id.*

2. With Respect to this Issue, the Simplification Act Clarifies Existing Law.

Although the Simplification Act had many purposes, this amendment was designed to clarify Congress' original intent in adopting the Act. Senator Garn, one of the principal authors of the Simplification Act, specifically indicated that the amendment simply clarified existing law:

> Many cases have resulted from the complex security interest disclosure requirements under the law. An illustrative case is *Gennuso* v. *Commercial Bank and Trust Company,* 455 F. Supp. 461 (W.D. Pa 1976); 566 F.2d 437, (3rd Cir. 1977), which required the creditor's right in property insurance proceeds and unearned property insurance premiums to be disclosed as a "security interest". *Although as presently written the law does not require that result, S. 108 should prevent such ludicrous interpretations* by requiring merely a positive indication if a security interest is being taken in the property purchased and if it is in property not being purchased in the transaction, simply a general listing of the type of property without a listing of incidental related interests. [Emphasis added.]

125 Cong. Rec. S4990 (daily ed. May 1, 1979).

The Board also regards the provisions of the Simplification Act concerning security interest disclosure as clarify-

ing the intent of the original Act. According to the Board's analysis, the effects of the Simplification Act can be put into five categories, one of which is the clarification of "certain complex legal questions that have produced conflicting court decisions in the past." 45 Fed. Reg. at 80731 (Dec. 5, 1980). The Board specifically noted that one of the legal issues which was clarified by the Simplification Act is "adequate disclosure of security interests." *Id.* at 80733.

This Court has repeatedly recognized that "subsequent legislation reflecting an interpretation of an earlier act is entitled to great weight in determining the meaning of the earlier statute." *Regents of University of California* v. *Bakke,* 438 U.S. 265, 349 (1978) (opinion of Justices Brennan, White, Marshall and Blackmun). *Accord, NLRB* v. *Bell Aerospace Co.,* 416 U.S. 267, 275 (1974); *Red Lion Broadcasting Co.* v. *FCC,* 395 U.S. 367, 380-81 (1969).

The Court recently applied this principle in *Seatrain Shipbuilding Corp.* v. *Shell Oil Co.,* 444 U.S. 572 (1980), which involved the construction of a section of the Merchant Marine Act. The Court examined first the language of the statute and the original legislative history, but found no evidence that Congress had addressed the precise question before the Court. The Court then examined the legislative history of subsequent amendments to the statute and found that a later Congress had expressed a clear understanding of how the question was to be treated under the original statute. The Court adopted the interpretation of the later Congress, noting that

> while the views of subsequent Congresses cannot override the unmistakable intent of the enacting one, . . . such views are entitled to significant weight, . . . and particularly so when the precise intent of the enacting Congress is obscure. [Citations omitted.]

444 U.S. at 596. In the instant case, the Simplification Act, reflecting Congress' interpretation of the original Act, is

thus entitled to great weight in establishing that Congress did not require disclosure of the assignment provision as a security interest under the original Act.

D. Although The Judicial Decisions On This Issue Are Sharply Divided, The Courts Which Have Looked To The Purpose Of The Act Have Held That The Assignment Provision Need Not Be Disclosed As A Security Interest.

Since prior to the adoption of the original Act in 1968, virtually the entire consumer credit industry has disclosed the retention of incidental interests in insurance on financed collateral on the back of installment contracts. *See* the brief filed herein by *amici curiae* Consumer Bankers Association, General Motors Acceptance Corporation and National Consumer Finance Association. Because incidental interests in insurance were not regarded as being within the ambit of "security interests" required to be disclosed under the Act, this form of disclosure has continued to be used in millions of credit transactions involving billions of dollars. Yet, it was not until 1976 that the first case alleging that such form of disclosure violated the Act was decided. Once invented, however, theories of technical violations of the Act tend to wash across the country in waves as plaintiffs (and their counsel) seek to recover the penalties provided by the Act. As a new claim—no matter how novel—begins to appear in reported cases, the wave begins to expand and pick up force and intensity.[8]

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[8] More than 13,000 lawsuits under the Act had been filed in the federal courts as of June 30, 1979. The Board recently stated that much of this litigation "concerned aspects of disclosures apart from credit cost disclosures, the critical elements of Truth in Lending according to Congress. Notable among disputed areas in the late 1970's were identity of the creditor, security interest issues, disclosure of loan proceeds, acceleration clause issues, and issues of rescission." 45 Fed. Reg. 80732 (Dec. 5, 1980).

The question of whether an assignment of unearned insurance premiums and insurance proceeds must be disclosed as a security interest under the Act is such a wave, which first formed in the Northern District of Georgia in 1976. Since then, the question has been much litigated, and the cases are sharply divided.[9] These conflicting decisions have created strong cross-currents on this issue which present the danger of white water rapids for creditors who must conform their contract forms to the law or face stiff penalties. Ford Credit submits that the reason for the conflicting decisions is that a number of courts have failed to look to the Congressional purpose underlying the Act.

The first district court decisions within the Northern District of Georgia reached opposite results. In *Edmondson* v. *Allen-Russell Ford, Inc.*, No. C75-940A (N.D. Ga. 1976) (Add. 18-26), the district court held that an assignment of unearned insurance premiums was a security interest which must be disclosed. However, that decision was soon fol-

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[9] Cases holding that such assignment must be disclosed as a security interest include: *Souife* v. *First National Bank of Commerce*, 628 F.2d 480 (5th Cir. 1980), *pet. for reh. en banc pend.* (Add. 53); *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556 (8th Cir. 1980); the Seventh Circuit's decision below; *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979); *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977); *Hagler* v. *Ford Motor Credit Co.*, 381 So.2d 80 (Ala. App. 1980); and *Luczak* v. *General Motors Acceptance Corp.*, 494 F.Supp. 210 (W.D.N.Y. 1980).

Cases holding that such assignment need not be disclosed as a security interest include: *James* v. *Ford Motor Credit Co.*, ____ F.2d ____ (10th Cir. 1980) (Add. 27-39); *Mullen* v. *North Pacific Bank*, 610 P.2d 949 (Wash. App. 1980); *Ancrum* v. *Charleston Lincoln Mercury, Inc.*, No. 78-804 (D.S.C. 1980) (Add. 1-10); *Ector* v. *Southern Discount Co.*, No. C78-899A (N.D. Ga. 1980) (Add. 11-17); and *Rounds* v. *Community National Bank*, 454 F.Supp. 883 (S.D. Ill. 1978).

lowed by a contrary holding from the same district in *Shanks* v. *Greenbriar Dodge, Inc.*, No. C75-1154A (N.D. Ga. 1976) (Add. 40-52). The Fifth Circuit affirmed *Edmondson*, 577 F.2d 291 (5th Cir. 1978), and reversed *Shanks*, 577 F.2d 296 (5th Cir. 1978), without discussing whether the result it reached was consistent with Congressional intent or would further the purpose of the Act.

This pattern of conflicting holdings is also illustrated by the decisions of the lower courts in the Seventh Circuit. In *Rounds* v. *Community National Bank*, 454 F. Supp. 883, 888 (S.D. Ill. 1978), the court held that the assignment provision was not a Truth in Lending security interest:

> The provisions impose no claim against, nor risk to, the plaintiff's assets. If such ephemeral interests are to be deemed to be security interests within the disclosure requirements of the Act, that determination should emanate from Congressional enactment or from a determination of the Board, not from a judicial decree.

As discussed above in the Statement of the Case, the first opinion of the district court in this case likewise held that the assignment provision is not a security interest. (J.A. 10-12). However, the district court vacated its first opinion and reversed its position based upon the Fifth Circuit's decision in *Edmondson*. (J.A. 19-21).

The Seventh Circuit, in the decision below, held that the Act was violated by a failure to disclose an assignment of unearned insurance premiums as a security interest, but conceded that such violation was, at worst, "purely technical." (J.A. 50). The Seventh Circuit apparently felt compelled to apply a highly technical reading of the definition of "security interest" in Regulation Z, without regard to whether or not the result it reached would further the purposes of the Act. This point was candidly expressed in the concurring opinion of Judge Cudahy:

> I do not read it [the panel opinion] as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. . . .
>
> Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances, but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.
>
> To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit. (J.A. 63).

Enactment of the Simplification Act on March 31, 1980 should have put an end to this controversy, since, as discussed above, the legislative history of the Simplification Act made clear that Congress had never intended to require disclosure of the assignment provision. Relying upon those expressions of legislative intent, certain courts have held that the assignment provision need not be disclosed as a security interest. Other courts, however, have refused to defer to these explicit statements of Congressional intent and have persisted in enforcing a requirement which Congress never intended to impose.

The first decision to consider the Congressional intent expressed in the legislative history of the Simplification Act was *James* v. *Ford Motor Credit Co.*, __ F.2d __ (10th Cir. 1980) (Add. 27-39). Relying upon the legislative history and this Court's recent *Milhollin* decision, the Tenth Circuit held that "the Act does not require, and Congress did not

intend it to require, an exemplification of that interest [in unearned insurance premiums] on the face of the installment contract." (Add. 33). In its order denying the petition for rehearing, the court in *James* explained that, in accordance with this Court's precedents dealing with statutory construction, it had used the Simplification Act as an aid in determining the meaning of the present Act. (Add. 38-39).

In *Ancrum* v. *Charleston Lincoln Mercury, Inc.*, No. 78-804 (D.S.C. Aug. 19, 1980) (Add. 1-10), the court endorsed the approach taken by the Tenth Circuit in *James*:

> The inclusion of the assignment of unearned or returned insurance premiums and insurance proceeds would provide the consumer with "information overload". . . . The decision [in *James*] recognizes and enhances the intent of Congress to provide the consumer with a meaningful, non-technical, simple and concise disclosure. I therefore conclude that the assignment of insurance proceeds and unearned or returned insurance premiums do [sic] not constitute a security interest which is required to be disclosed on the face of the contract. (Add. 7).

The court in *Ancrum* distinguished the contrary holdings of *Gennuso, Edmondson* and *Valencia* on the ground that those decisions were rendered prior to enactment of the Simplification Act. (Add. 4).

The Eighth Circuit reached the opposite result in *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556 (8th Cir. 1980), holding that the assignment provision had to be disclosed as a security interest on the face of the installment contract. The court refused to be guided by the intent of Congress expressed in the Simplification Act on the ground that the Simplification Act would not take effect for two years. *Id.* at 560. The court's analysis thus completely missed the

point that the Simplification Act was intended in pertinent part to clarify Congress' intent in the original Act and to correct the "highly technical judicial decisions" that Congress believed had misinterpreted the original Act.

The most recent appellate decision on this issue was *Souife* v. *First National Bank of Commerce,* 628 F.2d 480 (5th Cir. 1980), in which a Fifth Circuit panel declined to overrule *Edmondson* even in light of the expressions of Congressional intent found in the legislative history of the Simplification Act.[10] The panel's analysis of the legislative history of the Simplification Act is fundamentally wrong. For example, the court quoted the remarks of Senator Garn, which included the following statement pertaining to *Gennuso* v. *Commercial Bank & Trust Co.,* 566 F.2d 437 (3d Cir. 1977) (requiring disclosure of the assignment provision as a security interest):

> "Although as presently written the law does not require that result, S.108 should prevent such ludicrous interpretations. . . ."

628 F.2d at 484, *quoting* 125 Cong. Rec. S4990 (daily ed. May 1, 1979). The court then reached the astounding conclusion that those remarks did not indicate "that cases like *Edmondson* and *Gennuso* incorrectly interpreted the original Act." 628 F.2d at 484. The conclusion flies in the face of the language used by Senator Garn. Senator Garn characterized *Gennuso* as a "ludicrous interpretation" of the Act and clearly stated that the original Act did not require disclosure of the assignment provision. Thus, the Fifth Circuit panel failed to heed this Court's admonition in *Milhollin* that courts are not free to "embellish upon the reg-

[10] In an order entered December 5, 1980, however, the Fifth Circuit announced that it would defer consideration of the bank's petition for rehearing en banc pending this Court's decision in the instant case. (Add. 53).

ulatory scheme" by imposing penalties on creditors for non-disclosure of matters which are not required to be disclosed under the Act. 444 U.S. at 565.

In *Souife,* the Fifth Circuit panel also quoted the statement in the Senate Report that

> "a loan secured by an automobile (*not being purchased with the proceeds of the loan*) would require a statement indicating that the loan is secured by an automobile but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums. . . ." [Emphasis added.]

628 F.2d at 484, *quoting* S. Rep. No. 96-73, 96th Cong., 1st Sess. 16 (1979). The court attempted to distinguish this statement on the basis of the phrase italicized above since the automobile in the transaction before it had been purchased with the proceeds of the loan. 628 F.2d at 485. However, that distinction makes no difference. Under Section 614(a)(9) of the Simplification Act, 94 Stat. 179, the disclosure statement in a secured transaction must contain

> a statement that a security interest has been taken in (A) the property which has been purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type.

Thus, the statement quoted above from the Senate Report referred specifically to an automobile not purchased with the loan proceeds because it was describing the operation of Section 614(a)(9)(B). However, the same result would follow under Section 614(a)(9)(A), which requires only a statement that a security interest has been taken in the property purchased in the credit transaction. The Senate Report clearly states that the required disclosure of prop-

erty securing the loan need not include a listing of "incidental or related rights" such as an assignment of unearned insurance premiums. As discussed *supra* at pp. 20-21, the Board quoted this language from the Senate Report in support of its definition of "security interest" in the proposed revision of Regulation Z which excluded an assignment of unearned insurance premiums in *all* situations. There is no conceivable reason, and the Fifth Circuit panel in *Souife* suggests none, why such "incidental or related rights" must be disclosed with respect to property purchased with the loan proceeds, but not with respect to property purchased from other funds.

Thus, the pattern of conflicting judicial decisions is continuing, even in the face of the explicit statements of Congressional intent found in the legislative history of the Simplification Act. Only a decision from this Court can resolve the conflict and provide the credit industry with the guidance it needs on this issue.

E. Creditors Should Not Be Subject To The Penalties Imposed By The Act For Conduct Not Clearly Proscribed In The Act.

Under the Act a civil penalty is imposed upon a creditor for an amount equal to double the amount of the finance charge (up to a $1,000 maximum) for a violation of the Act. 15 U.S.C. § 1640(a). While the Act has been viewed as remedial in nature, the statute also imposes what are clearly penalties, as Congress has recognized in the body of the Act itself. Section 113 of the Act, 15 U.S.C. § 1612, expressly recognizes that the civil recovery provided for under Section 1640(a) is a "penalty". This Court noted in *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 375 (1973), that the Act contained penal sanctions, but found that the risk of imposing a penalty without first

giving fair warning of what conduct was prohibited was not present in that case because the language of the challenged rule was explicit. However, in the case at bar, the language of the Regulation is not at all clear, as demonstrated by the sharply conflicting interpretations of the courts.

Fundamental fairness and equity dictate that lenders not be held liable under the penal sanctions of the Act for conduct not clearly proscribed in the Act. Such sanctions should not be imposed under the guise of liberally construing the legislation, especially where, as here, the intent of Congress is not furthered by imposing the penalty. As discussed above, the purpose of the Act—to permit borrowers to comparison shop for credit—would be retarded by requiring disclosure of an incidental and transitory interest in unearned insurance premiums as a security interest.

II. THE FEDERAL RESERVE BOARD DOES NOT REQUIRE DISCLOSURE OF AN ASSIGNMENT OF UNEARNED INSURANCE PREMIUMS.

A. Great Deference Must Be Given To The Interpretations Of The Act And Regulation By The Board And Its Staff.

This Court has frequently held that the interpretation of a statute by the agency responsible for its administration is entitled to great deference. *E.g., Zenith Radio Corp.* v. *United States,* 437 U.S. 443, 450 (1978); *Mourning* v. *Family Publications Service, Inc.,* 411 U.S. 356, 371-72 (1973). When, as here, the construction of an administrative regulation rather than a statute is in issue, deference to the agency's interpretation is even more clearly in order. Indeed, such interpretation is controlling unless plainly erroneous or inconsistent with the regulation. *United States* v. *Larionoff,* 431 U.S. 864, 872 (1977); *Udall* v. *Tallman,* 380 U.S. 1, 16-17 (1965).

In *Ford Motor Credit Company* v. *Milhollin*, 444 U.S. 555, 565-68, this Court recently emphasized the need to defer to the Federal Reserve Board's interpretation of the Act and Regulation Z:

> [D]eference [to the views of the administrative entity appointed to apply and enforce a statute] is especially appropriate in the process of interpreting the Truth in Lending Act and Regulation Z. . . .
>
> . . . The Act is best construed by those who give it substance in promulgating regulations thereunder.
>
> Furthermore, Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth in-lending-law. . . .
>
> • • • •
>
> Finally, wholly apart from jurisprudential considerations or congressional intent, deference to the Federal Reserve is compelled by necessity; a court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views.

The Court also held that the same degree of deference should be accorded to the views of the Federal Reserve staff: "Unless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive. . . ." 444 U.S. at 565.

B. Proposed Official Staff Interpretation FC-0173 Expressly Holds That The Assignment Provision Need Not Be Disclosed As A Security Interest.

The Federal Reserve staff has recently issued a proposed Official Staff Interpretation which interprets 12 C.F.R. §§ 226.2(gg) and 226.8(b)(5) of the *present* Regulation and holds that the assignment of unearned insurance premiums

is *not* a security interest requiring disclosure under the Act. Proposed Official Staff Interpretation FC-0173 (Add. 54-57), 45 Fed. Reg. 63295 (Sept. 24, 1980). Recognizing that its interpretation is directly contrary to several circuit court decisions, the Federal Reserve staff stated that this interpretation better serves the purposes of the Act:

> The staff believes that *a creditor is not required* by this section [Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980)] *to disclose its right to receive insurance proceeds or unearned insurance premiums* nor to disclose that it is named as loss payee or beneficiary on an insurance policy. Truth in Lending disclosures are meant to provide useful information to consumers to enhance credit shopping. Consumers do need to know that they risk the loss of certain property if they default. The disclosures under § 226.8(b)(5) inform consumers of which property is subject to that risk at the time the credit decision is being made. We believe that information regarding the creditor's interest in insurance proceeds and unearned premiums would not be used in comparison shopping. *Although a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums, it is our opinion that such incidental interests are not the type of interests meant to be covered by § 226.8(b)(5).*
>
> The staff recognizes that there are a number of circuit court decisions to the contrary. We believe, however, that our position better serves the purpose of the statute and the regulation to convey in a meaningful way information that can be used by consumers in shopping for credit. (Add. 56) [Emphasis added.]

This interpretation clearly is a rational response to those overly technical judicial decisions, discussed above, which imposed liability on creditors without furthering the purpose of the Act.

The fact that a staff interpretation such as this is issued after a credit transaction is consummated does not alter the deference to be given to such interpretation. In *Milhollin*, this Court considered whether certain credit contracts executed before 1976 violated the Act. Relying upon an Official Staff Interpretation issued in 1977, this Court upheld the form of disclosure used by Ford Credit with respect to contracts which predated the Official Staff Interpretation. 444 U.S. at 563-65 and 567, n.11.

The staff recently announced that it has determined to defer final action on the proposed interpretation pending this Court's decision in the instant case. 45 Fed. Reg. 84074 (Dec. 22, 1980) (Add. 58). That action in no way represents a change in the Board's or the staff's position on the merits of this issue. Rather, it reflects a long-standing reluctance on the part of the Board and its staff to get involved in pending private litigation. *See* Federal Reserve staff letters dated January 9, 1970 and October 22, 1970, [1969-74 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶¶ 30,261 and 30,596. In these circumstances, it is still appropriate to give great weight to the informed judgment of the Board and its staff—as expressed in the proposed revision of Regulation Z (*see* pp. 20-22, *supra*) as well as in proposed interpretation FC-0173—that the assignment provision at issue here need not be disclosed as a security interest.

III. A DECISION BY THIS COURT REQUIRING DISCLOSURE OF THE ASSIGNMENT PROVISION, UNLESS GIVEN ONLY PROSPECTIVE APPLICATION, WOULD CAUSE INJUSTICE AND HARDSHIP TO THE CONSUMER CREDIT INDUSTRY.

Ford Credit contends that this Court should reverse the decision below on the merits for the reasons stated in Parts

I and II of this brief. If, however, this Court were to affirm the decision below and to rule that the assignment provision must be disclosed as a security interest under the Act, then Ford Credit urges that such ruling be given only prospective application except as to the Buyers.

In appropriate circumstances, judicial decisions are given only prospective effect. The use of prospective relief has been endorsed by judges and commentators alike.[11] Prospective relief is granted to avoid the undue or unnecessary hardship of retroactive application of a decision. B. Cardozo, *The Nature of the Judicial Process,* 146-49 (1921). Through the use of prospective relief, a court is able to decide unresolved questions while maintaining stability and avoiding hardship. T. Fairchild, *supra,* 51 Marq. L. Rev. at 269-70.

The guidelines for determining when a ruling should be given prospective application in a civil action were set forth by this Court in *Chevron Oil Co.* v. *Huson,* 404 U.S. 97, 106-07 (1971):

> First, the decision to be applied nonretoactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will

[11] T. Fairchild, *Limitation of New Judge—Made Law to Prospective Effect Only: "Prospective Overruling" or "Sunbursting",* 51 Marq. L. Rev. 254, 269-70 (1967-68); W. Schaefer, *The Control of "Sunbursts": Techniques of Prospective Overruling,* 42 NYU L. Rev. 631, 637 (1967); F. Beytagh, *Ten Years of Non-Retroactivity: A Critique and a Proposal,* 61 Va. L. Rev. 1557 (1975).

> further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." [Citations omitted.]

As discussed below, this case satisfies the *Chevron* guidelines for prospective relief.

A. An Adverse Decision On This Issue Was Not Clearly Foreshadowed.

The first *Chevron* guideline does not limit the doctrine of prospective relief to cases where the prior authorities were unanimous on the point at issue. Instead, this Court has given only prospective application to cases which decide an issue of first impression whose resolution was not "clearly foreshadowed." For example, in *Lemon* v. *Kurtzman,* 411 U.S. 192, 206-07 (1973), the Court was faced with the question of whether its decision that a state statute was unconstitutional should be applied retroactively. There had been disagreement over the validity of the statute beginning with the first decisions at the district court level and continuing up to this Court. The Court ruled that retroactive application was not appropriate since the issue it decided was one of first impression whose resolution was not clearly foreshadowed.

The Seventh Circuit refused to give only prospective application to the decision below on the ground that the weight of authority when the Contract was executed on September 30, 1977 was contrary to Ford Credit's interpretation of the Act. (J.A. 56). The Seventh Circuit is simply wrong in this analysis. As noted above, the case law is and has been sharply divided on this issue. Moreover, an examination of the cases decided prior to execution of the Con-

tract shows that Ford Credit's form of disclosure complied with the limited case law prevailing at that time.

During the first seven years that the Truth in Lending Act was in force, there were no reported decisions dealing with the assignment of unearned insurance premiums. As described above, there was no hint in the legislative history that this incidental interest was to be treated as a security interest under the Act. The Act and Regulation Z required disclosure of certain insurance information—but not information relating to unearned insurance premiums. Thus, Ford Credit and the entire consumer credit industry (*see* the brief filed herein by *amici curiae* Consumer Bankers Association, General Motors Acceptance Corporation and National Consumer Finance Association) relied on the Act, Regulation Z, the legislative history and the absence of any adverse decisions in continuing to disclose the assignment provision on the reverse side of installment contracts.

Three district court decisions were rendered on this issue before the September 30, 1977 date of the Contract in this case. No appellate decisions were rendered before that date. These district court decisions did not definitively resolve the issue or clearly foreshadow the result reached by the court below. These decisions certainly could not provide the basis for the industry to change immediately its standard contract forms. On balance, these decisions did not find fault with the industry-wide form of disclosure.

The first district court decision was *Edmondson* v. *Allen-Russell Ford, Inc.*, No. C75-940A (N.D. Ga. 1976) (Add. 18-26), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979), in which the district court accepted Magistrate Cohen's recommendation and held that an assignment of unearned insurance premiums was a Truth in Lending Act security interest. However, after making an initial recom-

mendation in *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. 1976) (Add. 40-52), *rev'd*, 577 F.2d 296 (5th Cir. 1978), similar to his recommendation in *Edmondson*, Magistrate Cohen withdrew his recommendation and stated that he would not follow his previous ruling. (Add. 42). The district court in *Shanks* accepted the magistrate's revised position. Therefore, the prevailing precedent in the Northern District of Georgia in 1977 was the holding in *Shanks* that an assignment of unearned insurance premiums did not create a security interest requiring disclosure under the Truth in Lending Act.

The ruling in the third case on point, *Gennuso* v. *Commercial Bank and Trust Co.*, 425 F.Supp. 461 (W.D. Pa. 1976), also supported the position taken by Ford Credit and the credit industry generally. *Gennuso* held that even if an assignment of unearned insurance premiums were regarded as a security interest, it need not be specifically disclosed on the face of a credit contract. That decision was reversed by the Third Circuit *after* the instant contract was executed. 566 F.2d 437 (3d Cir. 1977).

The issue decided below was before the Seventh Circuit for the first time. (J.A. 56). That decision constituted a sharp break from the first two decisions on this issue by district courts in the Seventh Circuit—the decision in *Rounds* v. *Community National Bank*, 454 F.Supp. 883 (S.D. Ill. 1978), and the first opinion below (J.A. 9-18)—both of which held that an assignment of unearned insurance premiums was not a "security interest" requiring disclosure under the Act. These district court decisions are strong evidence that the limited judicial precedents available to the district courts (and the credit industry) as late as 1978 endorsed the form of disclosure made by Ford Credit here in 1977. When even the district courts sitting in the Seventh Circuit Court of Appeals failed in 1978 to predict correctly

how the Seventh Circuit would rule on the issue decided in its March 20, 1980 opinion, Ford Credit does not understand how that court could conclude that its decision was "clearly foreshadowed" (J.A. 56) at the time the Contract was executed in 1977.

The fact that the Circuit Courts of Appeals are split today with respect to contracts identical in all relevant respects supports Ford Credit's position that the law was and continues to be unclear on this issue. Moreover, the fact that the Federal Reserve Board staff has taken a position contrary to the Seventh Circuit's interpretation in the decision below emphasizes that the Seventh Circuit's position was not clearly foreshadowed.

B. Retroactive Application Would Not Further The Purpose Of The Act.

As noted above, the central purpose of the Act is to require uniform credit cost disclosures so that consumers can comparison shop for credit. 15 U.S.C. § 1601(a). Nowhere in the Seventh Circuit's lengthy opinion below was there any explanation of how its decision would further that purpose. The two expressly "reluctant" concurring opinions below by Judges Cudahy and Swygert noted in pertinent part that the court's holding would require "the prominent disclosure of a rather esoteric right" which if disclosed as a "security interest" merely "add[s] virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit." (J.A. 63). While admitting that the violation of the Act found by it was "purely technical," the court below concluded that the credit industry should address its concern about the technical nature of certain requirements under the Act to Congress or to the Federal Reserve Board, not to the courts. (J.A. 50).

The credit industry has pursued the avenues suggested in the opinion below. As discussed above, the Federal Reserve staff recently issued Proposed Official Staff Interpretation FC-0173 under the present Act endorsing the form of disclosure used by Ford Credit and other consumer lenders. But, as noted above, the staff has deferred final action on the proposed interpretation pending the outcome of this case (Add. 58), thereby leaving the credit industry closer to the troubled waters of conflicting judicial decisions[12] than is proper, particularly in light of the clarity of the staff's position on the merits of this issue.

The credit industry expressed to the Congress its concern over the technical nature of certain requirements of the Act, as interpreted by the courts. By adopting the Simplification Act, Congress acted to "eliminate litigation based on purely technical violations of the Act." S. Rep. No. 96-73 at 17, [1980] U.S. Code Cong. & Ad. News at 892. But the Simplification Act will not become effective until April 1, 1982. 94 Stat. 185. Therefore, until the effective date of the Simplification Act or final action by the Federal Reserve staff, only this Court's hand, guided by the *Chevron* standard, can avoid the unfairly harsh result which would occur if an adverse decision by this Court—involving a purely technical and highly debatable claim under the Truth in Lending Act —were applied retroactively. Prospective application in this

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[12] By disclosing the assignment of unearned insurance premiums as a security interest at a time when the prevailing case law held that it was not, Ford Credit would have risked violating the Act by disclosing an over-inclusive security interest. " 'Describing a security interest where there is none' has been held to be 'additional and misleading information' " in violation of Regulation Z, 12 C.F.R. § 226.6(c). *Bartlett* v. *Commercial Federal Savings and Loan Association*, 433 F. Supp. 284, 287 (D. Neb. 1977).

case would be in accord with the intent of Congress as expressed in the Simplification Act.

Furthermore, retroactive application of such a decision would not result in more "meaningful disclosure" to consumers since conforming disclosure statements could only be given in future transactions. Retroactive application of unanticipated rulings would encourage lenders to make myriads of new disclosures in consumer contracts at the slightest shift in judicial currents, fearing that even the most strained reading of the Act today might tomorrow result in a holding of liability. Extensive additions to the disclosure statement will detract from really important information and will cause many borrowers not to read or understand the disclosure statement. The better solution is to apply prospectively any such technical decision in order to allow lenders time to add to their contracts only those provisions deemed necessary for the informed use of credit.

Prospective application of the statutory penalties would promote compliance with this Court's interpretation of the Act by penalizing any lender who does not revise his forms to comply with a clear pronouncement by the Court. Retroactive application of the decision cannot deter previous technical violations but will simply promote litigation against lenders who have in good faith attempted to comply with the Act and Regulation Z at a time when virtually the entire lending industry placed such assignment provisions on the back rather than the front of millions of installment contracts.

C. A Retroactive Decision Would Be Grossly Inequitable.

Although the dollar amount involved in this action is small, it would be misleading to ignore the staggering vol-

ume of transactions that are subject to the Act and the Regulation and to which the principles adopted in this case will apply. There are millions of consumer credit contracts outstanding in the United States today for automobile transactions alone representing more than $100 billion in consumer installment indebtedness.[13] Although these contracts vary significantly in their credit terms, they typically contain a reverse side disclosure of the assignment of unearned insurance premiums. This Court's decision will thus affect millions of consumer installment contracts subject to the Act and the Regulation. Retroactive application would simply provide windfall recoveries where there has been no injury, based on hyper-technical and ever-evolving constructions of the Act that threaten to disrupt established lending practices without furthering the goal of truth in lending.

The Truth in Lending area is particularly appropriate for prospective application of decisions. Many claimed violations of the Act (including the one alleged in this case) are highly technical and do not affect the borrower's understanding of the cost of credit or the terms of the loan. In *Sanders* v. *Auto Associates, Inc.*, 450 F. Supp. 900, 902 (D.S.C. 1978), Judge Chapman stated:

> Unfortunately, many of the truth in lending cases which have been instituted in this court have not been brought by plaintiffs who were misled or misinformed by the loan forms they attack. These plaintiffs have merely sought a windfall penalty from a lender by picking apart its loan form word by word in search of a technical deviation from the language of the statutes and regulations. The Truth in Lending Act was never

[13] According to the Board, consumer installment indebtedness outstanding in the United States for automobile transactions alone was $102,468,000,000 at year end 1978. 66 Federal Reserve Bulletin A40 (Table 1.56) (1980).

> meant to make the district courts forums for word games between lenders and borrowers in which a borrower's attorney who is adept at using legalese and arguing technicalities is awarded a prize for himself and his client. In order to avoid such misuse of the Truth in Lending Act, this Court will strongly construe its provisions against borrowers who were not misled by a lender's disclosure but merely seek a penalty for finding a technical problem with the loan form which could not have conceivably influenced his choice of credit.

There is ample precedent for granting prospective relief here. Long before the Act was adopted, the area of consumer lending was an area of prospective application of decisions. For example, in *Hare* v. *General Contract Purchase Corp.*, 249 S.W.2d 973 (Ark. 1952), a particular form of installment contract had been used in reliance on judicial interpretations of the state's constitutional limitation on interest rates. In the *Hare* decision, the court announced a new rule declaring the old form of contract invalid, but applied it only to future contracts.

Prospective relief has similarly been granted under the Act when form contracts are involved in order to avoid unfairly harsh impacts on lenders. In *McDaniel* v. *Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978), the proper method of disclosure of an acceleration clause in the form contracts of three lenders was before the Fifth Circuit. In its decision, the *McDaniel* court found a violation of the Act respecting acceleration clause disclosure, but limited its ruling to transactions commencing 90 days after the date of the decision, except for the litigants in the case. Other courts have given only prospective application to decisions on the disclosure of security interests under the Act. *Ector* v. *Southern Discount Co.*, No. C78-899A (N.D. Ga. Sept. 15, 1980) (Add. 12-15) (only prospective application regarding failure to disclose assignment of homestead exemption as a security interest); *Sneed* v. *Beneficial Finance Co.*, 410

F.Supp. 1135, 1140-4 (D. Hawaii 1976) (only prospective application regarding disclosure of overinclusive security interest in after acquired property).

In short, the legislative history of the Act, a clearly reasonable interpretation of Regulation Z, and the case law prevailing when the Contract was executed all supported Ford Credit's form of disclosure. The purpose of the Act would not be advanced by giving retroactive application to an adverse ruling by this Court concerning the form of disclosure used by Ford Credit and virtually the entire consumer credit industry. It would be fundamentally unfair to impose potentially enormous penalties on the consumer credit industry for what is, at worst, a purely technical violation. If, in these circumstances, the Court rules against Ford Credit's position on the merits, such ruling should be given only prospective application except as to the Buyers.

CONCLUSION

For the reasons stated above, petitioners respectfully request the Court to reverse the judgment of the Court of Appeals below.

Respectfully submitted,

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ADDENDUM

ADDENDUM OF LEGAL AUTHORITIES

	PAGE
Ancrum v. *Charleston Lincoln Mercury, Inc.*, No. 78-804 (D.S.C. 1980)	Add. 1
Ector v. *Southern Discount Co.*, No. C78-899A (N.D. Ga. 1980) (pertinent excerpts)	Add. 11
Edmondson v. *Allen-Russell Ford, Inc.*, No. C75-940A (N.D. Ga. 1976)	Add. 18
James v. *Ford Motor Credit Company*, No. 78-1806 (10th Cir. 1980)	Add. 27
Shanks v. *Greenbriar Dodge, Inc.*, No. C75-1154A (N.D. Ga. 1976)	Add. 40
Souife v. *First National Bank of Commerce*, No. 78-2562 (5th Cir. Dec. 5, 1980) (order deferring consideration of petition for rehearing en banc)	Add. 53
Proposed Official Staff Interpretation FC-0173, 45 Fed. Reg. 63295 (Sept. 24, 1980)	Add. 54
Order suspending consideration of Proposed Official Staff Interpretation FC-0173, 45 Fed. Reg. 84074 (Dec. 22, 1980)	Add. 58

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
CHARLESTON DIVISION

ROSE MARY ANCRUM AND CHRISTOPHER ANCRUM, *Plaintiffs,* vs. CHARLESTON LINCOLN MERCURY, INC. AND FORD MOTOR CREDIT COMPANY, *Defendants.*	CIVIL ACTION NO. 78-804 ORDER OF SUMMARY JUDGMENT

This action was initiated by the Plaintiffs alleging four (4) violations by the Defendants of the Consumer Credit Protection Act, 15 USC § 1601 et seq. (commonly referred to as the Truth-In-Lending Act), and Regulation Z, 12 C.F.R. § 226.1 et. seq. stemming from a Consumer Credit transaction. The Plaintiffs seek statutory damages of One Thousand ($1,000) Dollars together with costs and attorney fees.

The Defendants answered the Complaint denying the material allegations. Additionaly, the Defendant, Ford Motor Credit Company, (hereinafter referred to as "Ford Credit") interposed a Counterclaim for the balance owed on the underlying debt.

Depositions were taken and are of record in these proceedings. Cross-Motions for Summary Judgment have been filed and oral argument upon the Motions has been heard.

On May 26, 1977 the Plaintiffs purchased a used 1975 Mercury, Comet automobile from Charleston Lincoln Mer-

cury, Inc. (hereinafter referred to as "Dealer") for the sum of Two Thousand Nine Hundred Forty-Seven and 12/100 ($2,947.12). In order to finance a portion of the purchase price, the Plaintiffs executed a South Carolina Retail Installment Contract. This Contract is a preprinted form prepared by the Defendant, Ford Credit. The terms of the transaction were entered onto the form and the form contract completed by the Dealer.

Ford Credit is a wholly owned subsidiary of Ford Motor Company. It provides the wholesale financing for the Dealer, commonly referred to as "floor planning". Ford Credit has provided a capital loan to the Defendant Dealer. Additionally 52% of the finance contracts resulting from sales of vehicles by the Dealer during 1977 and 1978 were assigned to Ford Motor Credit Company.

After the Plaintiffs executed the Retail Installment Contract, the Dealer executed the Contract as "Seller" through its Secretary-Treasurer under a provision which reads as follows:

> "The foregoing Contract hereby is accepted by the Seller and assigned to Ford Motor Credit Company in accordance with the terms of the assignment set forth on the reverse side hereof."

Thereafter, Ford Credit accepted assignment of the Contract, notified the Plaintiffs of the assignment and the Plaintiffs began making their payments to Ford Credit.

This Court has jurisdiction over the parties and the subject matter by virtue of 15 U.S.C. § 1640(e).

The Plaintiffs' first contend that the Contract fails to disclose a security interest taken by the Defendants in the proceeds of physical damage insurance and unearned or returned insurance premiums.

The Truth-In-Lending Act, 15 USC § 1638(a)(10), requires that the disclosure statement include the following:

> "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates."

There is no definition of the term "Security Interest" or "Security" in the Act. However, the regulations promulgated under the Act 12 C.F.R. § 226.2(g) provide:

> " 'Security Interest' and 'Security' mean any interest in property which secures payment or performance of an obligation. The terms include but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust and [various liens and a lease interest securing performance of an obligation]"

The Plaintiffs in this case contend that the provision for the assignment of unearned or returned insurance premiums and insurance proceeds from physical damage insurance, found in Paragraph 18 on the reverse side of the Contract form constitutes a security interest which is not disclosed on the face of the document. The front of the document contains the following description of the security interest taken:

> "Security Interest": Seller shall have a security interest under the Uniform Commercial Code in the property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due thereunder."

Paragraph 18 of the Contract is among the additional terms and conditions incorporated into the Contract by reference. Paragraph 18, found on the back of the Contract, reads as follows:

> "Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained including returned or unearned premiums and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, . . . the proceeds from such insurance, by whomever obtained shall be applied toward replacement of the property or payment of the indebtedness hereunder in the sole discretion of the Seller."

There are three Circuit Court Decisions which have held that the failure to disclose the right to unearned and returned insurance premiums and proceeds of insurance, constitutes a violation of TILA, subjecting the Seller to liability. Two of these decisions involved the same written Contract as that which is before the Court in this Case. See *Edmondson* v. *Allen Russell Ford, Inc.* 5th Cir., 577 F.2d 291, Cert. denied, 441 U.S. 951; *Valencia* v. *Anderson Brothers Ford,* 7th Cir., F.2d ; and *Gennuso* v. *Commercial Bank and Trust Company,* (3rd Cir.) 566 F.2d, 437. These cases were all decided prior to the passage and approval by the President on March 31, 1980 of the "Truth-In-Lending Simplification and Reform Act" Title 6 of the "Monetary Control Act of 1980." P. L. 96-221, 94 Stat. 132.

Section 614(a) of the Truth-In-Lending Simplification and Reform Act amends 15 USC and § 1638 (a), which is the disclosure section of the Truth-In-Lending Act. Subsection (a)(9) of the Amendment reads as follows:

> "Where the credit is secured, [the creditor shall disclose to the extent applicable] a statement that a security interest has been taken in (a) the property which is purchased as part of the credit transaction, or (b) property not purchased as part of the credit transaction identified by item or type." U.S. Cong. & Adm. News, No. 3, May 1980, 94 Stat. 179.

The purpose of the Amendments to the original Act are clearly outlined in the Senate Report. S.R. 96-368, U.S.

Cong. & Adm. News, *supra*, p. 850, includes the following statement regarding the purpose of the 1980 Amendments:

> "Despite the act's clear successes, however, there is a growing belief among consumers and creditors alike that the act could be substantially improved. There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions. There is also evidence that many creditors have sincerely tried to comply with the act but, due to its increasing complexity and frequent changes, have nonetheless found themselves in violation and subject to litigation. In addition, this committee and other congressional and government sources have found the level of administrative enforcement by the Federal bank agencies seriously inadequate. In short, the committee believes that the interests of both consumers and creditors would be furthered by simplification and reform of the act."

The Senate Report addresses the specific amendment simplifying the security interest disclosure requirement, stating:

> "The security interest disclosure is also simplified to eliminate the technical disclosure of the type of security interest taken. When a security interest is being taken and property purchased as part of the credit transaction, this section requires a statement that a security interest has been or will be taken in the property purchased. When a security interest is being taken in property not purchased as part of the credit transaction, the committee intends this provision to require a listing by item or type of the property securing the transaction, but not a listing of related or incidental interests in the property. For example: a loan is secured by an automobile but would not require a listing of

> incidental or related rights which the property may have, such as insurance proceeds or unearned insurance premiums, rights arising under, or waived in accordance with State Law, accessions, accessories or proceeds." U.S. Cong. & Adm. News, *supra,* page 864.

Following the passage of the "Truth-In-Lending Simplification and Reform Act," the 10th Circuit Court of Appeals addressed this issue in the case of *James* v. *Ford Motor Credit Co.*, et. al., ____ F.2d ____ (decided June 24, 1980) (D.C. No. Civ. 78-F-647). The Court affirmed the lower court holding that the provision for the assignment of physical damage insurance proceeds and unearned or returned premiums did not constitute a security interest required to be disclosed under the Act. In so doing, the Court considered the Legislative history of the 1980 Amendments to the Truth-In-Lending Act to help in discerning Congressional intent.

In conjunction with the 1980 Amendments and their Legislative history, the Court further considered the recent decision of the United States Supreme Court, found in *Ford Motor Credit Co.* v. *Milhollin,* ____ U.S. ____ 48 L.W. 4145, decided February 20, 1980. In that decision the Court stated:

> "The concept of 'meaningful disclosure' that animates TILA (citation omitted), cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . 'information overload' (citations omitted) and striking the appropriate balance is an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." (Emphasis in original).

Analogizing the statement of the Supreme Court in *Milhollin* to the 1980 Amendments and their legislative history, the *James* Court reasoned:

> "The *Milhollin* approach parallels the intent of Congress in enacting the 1980 Amendments and the legislative history of those Amendments. The effort is to strengthen the impact of TILA by simple, concise disclosures which can be understood by consumers and creditors." *James* v. *Ford Motor Credit Co., supra,* p. 9.

Applying this reasoning, the Court concluded:

> "We are convinced that the Act does not require and Congress did not intend it to require, an exemplification of that interest on the face of the installment contract . . .
>
> "The application of *Milhollin* and the 1980 actions of Congress present no retroactivity problem. We are concerned only with civil liability for nondisclosure. The buyers have shown no damage. Our decision establishes no new principle of law. Rather, it recognizes the Congressional intent. Application to this case furthers the operation of TILA and produces an equitable result. See *Chevron Oil Co.* v. *Huson,* 404 U.S. 97, 106-107.

The inclusion of the assignment of unearned or returned insurance premiums and insurance proceeds would provide the consumer with "informational overload". Conversely, the *James* decision, *supra,* strikes a ". . . balance between 'competing considerations' of complete disclosure . . . and the need to avoid 'informational overload'." *Ford Motor Credit Co.* v. *Milhollin, supra,* 48 L.W. at 4149. The decision recognizes and enhances the intent of Congress to provide the consumer with a meaningful, non-technical, simple and concise disclosure. I therefore conclude that the assignment of insurance proceeds and unearned or returned insurance premiums do [sic] not constitute a security interest which is required to be disclosed on the face of the contract.

The Plaintiffs secondly contend that the Defendant, Ford Credit was a "creditor", within the purview of the Act, and

should have been disclosed as such on the face of the Contract. The Plaintiffs argue that the failure to label Ford Credit as such is a violation. In support of this position, Plaintiffs point out the continuing business relationship existing between the Defendants.

It is the conclusion of this Court that Ford Credit is properly identified on the Contract. There is no labeling requirement. *Sadie Morris* vs. *Kate McLaurin Company and General Electric Credit Company* D.C.S.C., Civ. Act File No. 76-2407, July 8, 1978 aff'd USC 4th Cir. 78-1605, June 20, 1978.

Ford Credit is named on the face of the Contract in the provision found next to the designated place for the signature of the Buyer, in the provision which purports to assign the Contract to it from the Dealer. The provision reads as follows:

> "The foregoing Contract hereby is accepted by the Seller and assigned to Ford Motor Credit Company in accordance with the terms of the assignment set forth on the reverse side hereof."

The Contract properly identifies Ford Motor Credit Company in accordance with the requirements of the Act. *Augusta* v. *Marshall Motor Company, and Ford Motor Credit Company,* 453 F.Supp. 912 (D.C., Ohio), 1977; *Main* v. *Faller Ford,* et. al., Civ. No. 74-337, (W.D. Pa. April 22, 1976); *Milhollin* v. *Ford Motor Credit Company,* 588 F. 2d 753 (9th Cir. 1978).

Next the Plaintiffs argue that the failure to itemize the license, title and registration fee constitutes a violation of the Act. Regulation Z, 12 C.F.R. § 226.4 (b), lists types of charges which do not have to be included in the finance charge as long as they are itemized and disclosed to the consumer with the heading "other charges". Section

226.4 (b) itemizes the various charges, and subsection (4) reads "License, Certificate of Title and Registration Fees imposed by law".

The Federal Reserve Board issued its Staff Opinion on October 14, 1977 addressing this specific issue. See CCH § 31,724 (Consumer Credit Guide, Transfer Binder). That opinion states in applicable part as follows:

> "Staff is of the opinion that the three components within § 226.4 (b) (4) need not be separately itemized, if a creditor discloses the total fee comprising the three components and indicates the types of fees included within that total such fee qualifies for exclusion from the finance charge"

This Court has accorded substantial weight to the opinion of the Federal Reserve Board. See *Moore* v. *Great Western Savings and Loan Ass'n*, 513 F.2d 688, 690 (9th Cir., 1975); *Eby* v. *Reb Realty, Inc.*, 495 F.2d 646, 650 (9th Cir. 1974); *Bohn* v. *Hibernia Bank*, 493 F.Supp. 135 (9th Cir. 1974); *Taylor* v. *R. H. Macy and Co., Inc.*, 481 F.2d 178, 180 (9th Cir. 1973); *Douglas* v. *Beneficial Finance Company*, 468 F.2d 453, 456 n.2 (9th Cir. 1972); and *Mourning* v. *Family Publications Service*, 411 U.S. 356, 365 (1973).

There is no logical explanation for categorizing "License, Certificate of Title, and Registration Fees imposed by law "as one element to be disclosed if the authors of Regulation Z had intended for each component to be separately stated. The Regulation speaks for itself in this regard. *R. L. Knighten* v. *Century Dodge, Inc.*, Civ. No. 77-26 Mac. (M.D. Ga., 1978). Therefore, I conclude that the disclosure requirements of the Act and Regulation have been met, and their is no violation.

Finally the Plaintiffs contend that the handwritten addition on the Contract for a ". . . Doc Fee $25" which appears

next to the printed category heading "other charges", violates the Act and Regulation because it is not clear, conspicious and meaningful. The documentary fee is properly grouped with other charges. § 226.6(a) of Regulation Z specifically allows handwritten disclosures. The fee is legibly written. Finally, there is no requirement in the Act or Regulation that an added charge such as this be more conspicuous than other terms. This contention is without merit.

I have considered in detail each allegation of the Plaintiffs and find no violation of the Truth in Lending Act. Having disposed of these issues, the remaining issues concern the Counterclaim of the Defendant Ford Credit. I conclude that the Counterclaim is permissive and not compulsory. *Williams* v. *Beneficial Finance Company of Fayetteville, Inc.*, 599 F.2d 1322 (4th Cir., 1979). There is no independent jurisdictional basis for the counterclaim and it must, therefore, be dismissed. Therefore, it is

ORDERED that the Counterclaim of the Defendant, Ford Credit, be dismissed;

ORDERED that Judgment be entered for the Defendants dismissing the Complaint.

IT IS SO ORDERED.

/s/ FALION B. HAWKINS
Judge, United States District Court

Charleston, SC
August 18, 1980

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GENEVA ECTOR, *Plaintiff,* vs. SOUTHERN DISCOUNT COMPANY, *Defendant.*	CIVIL ACTION NO. C78 899A

EXCERPTS FROM SEPTEMBER 15, 1980 ORDER OF COURT AT 1, 15-20

ORDER OF COURT

Presently before the Court are the report and recommendation of United States Magistrate J. Owen Forrester and the parties' responses thereto. The magistrate recommends that the plaintiff's motion for summary judgment be denied. Although several difficult issues are presented, the Court APPROVES the recommendation that plaintiff's motion for summary judgment be DENIED and ADOPTS it as the order of the Court. The facts pertinent to each issue are set forth in connection with the individual discussion of the issue to which they pertain.

I. DISCLOSURE OF GEORGIA LOAN FEES IN CONNECTION WITH COMPUTATION OF PREPAID FINANCE CHARGE

• • • •

II. FAILURE TO DISCLOSE SECURITY INTEREST IN HOMESTEAD EXEMPTION

Plaintiff also complains of defendant's failure to disclose as a security interest on the front of the disclosure form the plaintiff's assignment of her homestead exemption. Defendant does not object to the magistrate's conclusion that this failure constitutes a violation under *Elzea* v. *National Bank of Georgia,* 570 F.2d 1248 (5th Cir. 1978). Plaintiff objects, however, to the further conclusion that defendant is entitled to a defense under 15 U.S.C. § 1640(f) (quoted *supra* p. 14). Defendant contends, relying upon the affidavit of its Senior Vice President, that it drafted its disclosure according to the interpretation given Regulation Z, 12 C.F.R. § 226.2(gg), by this Court in *Mims* v. *Dixie Finance Corp.,* 426 F.Supp. 627 (N.D. Ga. 1976) (*en banc*). *Mims* was in effect overruled by *Elzea.*

As did Judge Freeman in *Hamilton* v. *Southern Discount Co.,* No. 79-27A (N.D. Ga. May 30, 1980), the undersigned declines to rule upon the question whether section 1640(f) comprehends judicial interpretations of Regulation Z. *But see* note 7, *infra.* Instead, the Court concurs in the conclusion reached by Judge Freeman in *Hamilton* that *Elzea* should be given only prospective application. In light of the recent Fifth Circuit decision in *Travis* v. *Trust Company Bank,* Nos. 78-2812, 78-2890 (5th Cir. July 9, 1980), the endorsement of Judge Freeman's decision must be qualified as explained below. Judge Murphy has reached the same conclusion as did the *Travis* court in *Brown* v. *Termplan,* 459 F.Supp. 160 (N.D. Ga. 1978).

The Supreme Court has set forth a three-part inquiry for determining whether a given judicial decision ought to be applied retroactively:

> In our cases dealing with the nonretroactivity question, we have generally considered three separate fac-

> tors. First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, *see e.g., Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, [392 U.S. 481, 496], or by deciding an issue of first impression whose resolution was not clearly foreshadowed, *see, e.g., Allen* v. *State Board of Corrections,* [392 U.S. 544, 572]. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." *Linkletter* v. *Walker,* [351 U.S. 618, 629]. Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results of [sic] applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." *Cipriano* v. *City of Houma,* [395 U.S. 701, 706].

Chevron Oil Co. v. *Huson,* 404 U.S. 97, 106-07 (1971).

In *Travis* and in *Brown,* the courts began their discussions by noting that the transactions involved ante-dated this Court's opinion in *Mims* and that as a result the lender could not have relied on *Mims. Travis,* slip op. at p. 7108; *Brown,* 459 F.Supp. 160, 162. The *Travis* court also went on to conclude that the [sic] in *Elzea* should have been anticipated by "reasonable, prudent creditors." Slip. op. at 7108. In the instant case the transaction at issue post-dated *Mims,* and the defendant undisputedly relied upon *Mims.* Thus *Elzea* "establish[ed] a new principle of law . . . by overruling clear past precedent on which litigants may have relied. . . ." *Chevron,* 404 U.S. 97, 106. Indeed, defendant not only "may have relied" but did in fact rely upon *Mims.* As a result of this actual reliance, the Court need not be concerned with *Travis'* discussion of the foreseeability of the *Elzea decision.* In any event such foreseeability must

be viewed in light of defendant's undisputed actual reliance upon *Mims*.

In answering the second *Chevron* inquiry, the *Travis* court emphasized that the Truth in Lending Act is designed to deter disclosure violations and not merely to compensate actual injuries. The purpose of the Act and the private enforcement scheme adopted by Congress would "be better served by having *Elzea* apply retroactively." Slip. op. at 7108. In this case retroactive application of *Elzea* would not meaningfully deter this defendant or others from disclosure violations. With respect to the sort of disclosure now required by *Elzea*, the defendant conformed its disclosure to the then-current state of the law as expressed in this Court's *en banc* decision in *Mims*. Thus, the defendant having done all that was then required by law, the retroactive application of *Elzea* to this transaction would be an example of the strictest, most absolute liability without fault. Such liability is required by neither the purpose nor express language of the Truth in Lending Act.

"The third test of *Chevron* is whether inequitable results would arise if the *Elzea* holding is applied retroactively." *Travis*, slip op. at 7109. The *Travis* court noted that the defendant lender in that case had changed its consumer lending forms early in 1976 and that as a result, the one-year statute of limitations in 15 U.S.C. § 1640 made it unlikely that the defendant would suffer great exposure. There are no facts before this Court indicating the potential exposure of Southern Discount on loan contracts similar to the one at issue here. This Court nevertheless believes that an inequitable result would arise from the imposition of *any* liability upon this defendant after its undisputed, good faith, actual reliance upon an *en banc* decision of this Court.

Thus, with respect of each of the inquiries mandated by *Chevron,* this Court believes the undisputed good faith, actual reliance of the defendant on the *en banc* decision in *Mims* to be significant grounds for distinguishing this case from the *Travis* case. Thus, the Court will not apply *Elzea* retroactively to transactions in which the lender undisputedly actually relied upon *Mims.*[7]

III. FAILURE TO DISCLOSE ALLEGED SECURITY INTEREST IN PROCEEDS OF INSURANCE

Plaintiff also complains that defendant failed to disclose the following language on the front of the disclosure as a security interest:

> Borrower will keep the collateral (which shall be at Borrower's risk), insured for a reasonable amount against loss by fire or theft (also accidental physical damage on motor vehicles). The proceeds of property insurance shall be payable to both Lender and Borrower as their interests may appear; and Lender may apply insurance proceeds paid to it at its option to repair property or to the debt.

This district has held previously that such an assignment of insurance proceeds need not be disclosed as a security interest. *E.g., Bohanan* v. *Southern Discount Co.,* C79-255A (N.D. Ga. July 30, 1980) (Freeman, J.); *Hardy* v. *Southern Discount Co.,* C79-1052A (N.D. Ga. July 23, 1980) (Shoob,

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[7] Although the Court need not decide the precise question of the applicability of 15 U.S.C. § 1640(f), obviously the above discussion has much the same effect as applying 1640(f). In defining the issue before it, the *Travis* court suggested a close relationship between the good faith reliance issue and the retroactivity issue when it stated that "Appellant contends that the civil liability provisions of TILA do not apply when there is good faith reliance upon case law, and therefore, that *Elzea* should be applied prospectively only." Slip op. at 7107.

J.); *Bolden* v. *Maryville Loan and Finance Corp.*, No. C76-130A (N.D. Ga. 1977) (Freeman, J.) *appeal docketed* No. C78-1050 (5th Cir. Jan. 6, 1978); *Bolden* v. *Legal Securities, Inc.*, No. C76-845A (N.D. Ga. 1977) (Henderson, J.); *Jones* v. *State Loan and Thrift Corp.*, No. C75-2148A (N.D. Ga. 1977) (Edenfield, J.). Recent Fifth Circuit cases have construed the term "security interest" somewhat broadly. *E.g., Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978); *Elzea, supra.*

The undersigned believes that in technical areas of the law, uniformity of decisions is often desirable. This is especially so in truth in lending, where a good faith attempt by a lender to satisfy one decision-maker could cause the lender to run afoul of the dictates of another decision-maker. The Act's purpose of enhancing meaningful disclosure so that borrowers may intelligently shop for credit is promoted when all lenders are attempting to follow the same legal authority. But where lender A drafts notes according to a decision of Judge X and lender B drafts notes according to a differing decision of Judge Y, the lending community's resulting confusion will be reflected in confusing disclosures of credit information. Both lenders and borrowers are thus best served by a single, rational line of legal authority governing truth in lending disclosure. That line of authority may not always be absolutely correct, but it is, of course, correctable by appeal. In that regard, the Court notes that one of the cases cited above is already on appeal and was argued in December, 1979. Until such time as the Fifth Circuit rules, this Court will adhere to the precedent of *Bolden*, *Bolden*, and *Jones*.

Thus, for the reasons set forth in this part of the order, the Court finds no violation in defendant's failure to disclose the assignment of insurance proceeds as a security

interest, and for all the reasons set forth above the Court APPROVES and ADOPTS as the order of this Court the magistrate's recommendation that the plaintiff's motion for summary judgment be DENIED. Although defendant has not moved for summary judgment, this order would appear to dispose of the case. Accordingly, plaintiff may show cause within ten (10) days why judgment should not be entered for defendant.

SO ORDERED, this 15 day of Sept., 1980.

/s/ Charles A. Moye, Jr.
UNITED STATES DISTRICT JUDGE

RECOMMENDATION OF SPECIAL MASTER
APRIL 29, 1976

IN THE
UNITED STATES DISTRICT COURT
For the Northern District of Georgia
Atlanta Division

CATHERINE EDMONDSON,
Plaintiff,

vs.

ALLEN-RUSSELL FORD, INC. and FORD MOTOR CREDIT COMPANY,
Defendants.

CIVIL ACTION
NO. C75-940A

RECOMMENDATION OF SPECIAL MASTER

Before the Court is an earlier recommendation of the dismissal of Allen-Russell Ford, Inc. pursuant to settlement agreement. Also before the Court are motions for summary judgment by plaintiff and defendant Ford Motor Credit Company.

Plaintiff's first contention centers on the undisclosed acceleration clause. That clause provides that on default, "Seller shall have the right to declare all amounts due or to become due hereunder to be immediately due and payable." This is clearly an undisclosed default charge. *Whitehead* v. *Harry White Ford,* C75-695A (Freeman, J. 1976).

Plaintiff's second contention is that the defendant violated the Act by failing to itemize the finance charge even though the finance charge is composed of only a single element. In the case of a credit sale of goods, such as in the

case at bar, that single element is called time price differential. In the case of a loan, that single element is called interest.

With respect to both credit sales and credit loans, Regulation Z requires disclosure of "the total amount of the finance charge with description of each amount included, using the term finance charge." Regulation Z § 226.8(c)(8) and (d)(3). This is not the clearest language. It does not appear to contemplate the single-element finance charge. It is at least ambiguous as to whether the finance charge must have a dual label when composed of a single element.

Very early in the history of truth in lending, in 1969, a pamphlet was published entitled *What You Ought to Know about Truth in Lending*. The pamphlet stated: "Material in this pamphlet has been prepared by the Board of Governors of the Federal Reserve System." Attached are relevant portions of that pamphlet. The Board gave very clear examples in Exhibits A, B, C and D, that where the finance charge contained a single element, the label "finance charge" alone should be used to describe that element. This pamphlet was issued before any contrary court decisions.

It is true that the pamphlet should not be totally relied upon as a substitute for the regulation, for business transactions and state law vary. But no such variation could affect the accuracy of the portrayal of the single label "Finance Charge."

Furthermore, in staff position letter No. 682, dated April 25, 1973, it was stated that only the single label "Finance Charge" was to be given to the single element finance charge and that to give a dual label could obscure the clear impact of the disclosure of finance charge and therefore be misleading and confusing. Attached hereto is a copy of that letter.

This district has never spoken on the issue of whether the single element finance charge should be given a dual label. But it has approved many disclosure statements where only the single label was given to the single element finance charge.

There is in this district one recommendation which treated the point. In *Paer* v. *First National Bank of Tucker*, C74-1402A, as a second reason for holding for the plaintiff, the Special Master noted that authority in other districts and staff letters required itemization of the finance charge even though composed of a single element, interest. The Special Master was correct in his citations of authority from other districts, but he did not cite staff position letter No. 682. In any event, that recommendation did not become precedent. Judge Freeman entered judgment on the recommendations because they were unopposed.

This Special Master notes the alternate holdings clearly supporting plaintiff's contentions in *Ives* v. *W. T. Grant Company*, 522 F.2d 749 (2nd Cir. 1975); *Ljepava* v. *M.L.S.C. Properties, Inc.*, 511 F.2d 935 (9th Cir. 1975); *Johnson* v. *Associates Finance, Inc.*, 369 F.Supp. 1121 (S.D. Ill. 1974); *Myers* v. *Clearview Dodge Sales, Inc.*, 384 F.Supp. 722 (E.D. La. 1974). This Special Master also notes that each of these decisions rules contrary to the law of this District on other points.

About four months after the decision in *Ives* v. *W. T. Grant, supra*, the Board of Governors promulgated an interpretive ruling that there is no need for description or identification where the finance charge is composed of a single element. Attached hereto is a copy of that ruling.

Now this Special Master does not recommend giving weight to letters written by Federal Reserve Board staff employees criticizing court decisions. *Willis* v. *Town*

Finance Corp. of Atlanta, C74-1489A (Moye, J.). But this Special Master thinks courts should be reluctant to declare that settled and consistent interpretations of the Board are erroneous. *Philbeck* v. *Timmers Chevrolet Company,* 499 F. 2d 971 (5th Cir. 1974).

Plaintiff contends that the Board's Interpretive Ruling is plain wrong. Plaintiff goes to the Act itself and cites 15 USC 1638(a)(6). That section provides that a creditor must disclose:

> . . . the amount of the finance charge, which may in whole or in part be designated as a time price differential or any similar term to the extent applicable.

With the permissive "may" this section certainly does not stand unambiguously in support of plaintiff's contention.

Plaintiff argues that legislative history of the Truth in Lending Act supports his contentions. But to the Special Master, the Regulations and interpretations of the Board are much more important in fixing the meaning of the Act. The Act delegates to the Board the power to make regulations containing:

> . . . such classifications, differentiations, or other provisions, and may provide for such adjustment and exceptions for any class of transactions as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. 15 USC 1604.

The Act also provides:

> Regulations of the Board need not require that disclosures pursuant to this part be made in the order set forth in this part, and may permit the use of terminology different from that employed in this part if it conveys substantially the same meaning. 15 USC 1632.

As Judge Edenfield noted in *Roberts* v. *National School of Radio & Television Broadcasting*, 374 F.Supp. 1266, 1269 (N.D. Ga. 1974)

> The Supreme Court has only recently observed that the authority and expertise which the Federal Reserve Board exerts in developing the enforcement provisions of the TIL is nearly absolute *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, . . . (1973).

Since the Board has stated its interpretation first and since this District Court has not held to the contrary, this Special Master concludes that the single label, "Finance Charge," is sufficient where the finance charge contains only a single element.

Plaintiff's third contention is that defendant failed to disclose its security interest in insurance proceeds, unearned insurance premiums, and personalty left in the car after repossession. Regulation Z § 226.8(b)(5) requires a clear identification of the property to which the security interest relates. The disclosed clause shows a security interest in the car "and in the proceeds thereof." The undisclosed clause dealing with property damage insurance to be obtained by Buyer for the protection of the interest of buyer and seller, reads:

> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release and settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the property or payment of the indebtedness hereunder in the sole discretion of seller.

First, let us deal with insurance proceeds in case of damage to the car. The question is whether those insurance proceeds are encompassed in the disclosed security interest in the car "and in the proceeds thereof." This Special Master concludes that proceeds from the involuntary, as well as the voluntary, disposition of the car are encompassed. Ga. Code Ann. § 109A-9-306; *PPG Industries, Inc.* v. *Hartford Fire Insurance Co.*, 384 F. Supp. 91 (S.D. N.Y. 1974); *Fireman's Fund American Ins. Co.* v. *Ken-Lori Knits, Inc.*, 399 F. Supp. 286 (E.D. N.Y. 1975). The equation of voluntary and involuntary disposition is ancient in the law. This is revealed in the well-known history of the relationship between the common law actions of trover and conversion on the one hand and assumpsit on the other. Where property was tortiously disposed of, the injured party could presume that the wrongdoer had promised to buy it. Thus, the injured party could waive the tort and sue assumpsit.

The next question is whether the defendant took a security interest in returned and unearned premiums for property damage insurance. The undisclosed clause states the buyer's interest is assigned. The last sentence of that clause speaks of use of the insurance proceeds to pay the debt. In the contract, insurance proceeds appear to include returned and unearned premiums. Thus, there is an assigned for purpose of security.

Now, the question is whether returned or unearned premiums from property damage insurance are included in the disclosed security interest in the car "and the proceeds thereof." There is no precedent known to the Special Master on this point. This Special Master concludes that those premiums are not included in that disclosed security interest. Those premiums might be proceeds of the insurance policy, but they are not proceeds of the car.

Thus, the defendant has failed to disclose its security interest in returned and unearned premiums of property damage insurance. The next question is whether this violation is so minimal that it should be disregarded. The answer is no. If the security interest was important enough for defendant to acquire, it was important enough to disclose.

With regard to personal property, an undisclosed clause of the contract provides:

> Any personalty in or attached to the Property when repossessed may be held by Seller without liability and buyer shall be deemed to have waived any claim thereto unless written demand by certified mail is made upon Seller within 24 hours after repossession.

This clause is not a part of any clause dealing with indebtedness. It does not create a security interest in the personalty to secure payment of the debt.

WHEREFORE, it is recommended that plaintiff's motion for summary judgment be granted and that plaintiff have judgment in the amount of $1,000 plus reasonable attorneys fees.

Plaintiff's attorney is directed to submit within ten days an affidavit of legal services.

This 29th day of April, 1976.

/s/ Ezra H. Cohen
Ezra H. Cohen
BANKRUPTCY JUDGE,
Sitting as Special Master

(Note: Exhibits omitted in printing.)

ORDER OF THE DISTRICT COURT
AUGUST 27, 1976

IN THE
UNITED STATES DISTRICT COURT
Northern District of Georgia
Atlanta Division

CATHERINE EDMONDSON,
Plaintiff,

vs.

ALLEN-RUSSELL FORD, INC. and FORD MOTOR CREDIT COMPANY,
Defendants.

CIVIL ACTION
NO. C75-940A

ORDER

This truth in lending action is before this court for review of the special master's recommendation of April 29, awarding judgment in favor of the plaintiff in the amount of $1,000 against defendant Ford Motor Credit Co. and of his recommendation of May 14, awarding the plaintiff $900 in reasonable attorney's fees. Also before this court is the master's recommended dismissal of the complaint as it relates to Allen-Russell Ford, Inc.

Upon review of the record, the court finds itself in agreement with the special master's conclusion that the defendant failed to disclose the fact that it asserted a security interest in returned or unearned premiums of the automobile insurance. Such a failure to dissolve is a violation of 12 C.F.R. 226.8(b)(5). The court therefore ADOPTS the special master's recommendation on this issue and AWARDS the plaintiff judgment in the amount of $1,000 and $900 in reasonable attorney's fees against de-

fendant Ford Motor Credit Company and DISMISSES the complaint as it relates to defendant Allen-Russell Ford, Inc.

So ORDERED, this 27th day of August, 1976.

/s/ NEWELL EDENFIELD
NEWELL EDENFIELD
United States District Judge

OPINION OF THE COURT OF APPEALS FOR THE TENTH CIRCUIT JUNE 24, 1980

UNITED STATES COURT OF APPEALS TENTH CIRCUIT

No. 78-1806

JODY JAMES AND BARBARA JAMES,

Plaintiffs-Appellants,

v

FORD MOTOR CREDIT COMPANY AND DEL NORTE MOTOR COMPANY,

Defendants-Appellees.

Appeal from the United States District Court for the District of Colorado (D. C. No. Civ. 78-F-647)

Richard J. Rubin (with him on the briefs were Paul L. Biderman and Timothy Meehan, attorneys for Northern New Mexico Legal Services, Inc. and Le Roy Cordova) for appellants.

Lawrence W. Treece (with him on the briefs were Holme, Roberts and Owen, and Richard L. Schrepferman and Jeffrey A. Chase) for appellees.

Before SETH, Chief Judge, BREITENSTEIN and DOYLE, Circuit Judges.

BREITENSTEIN, Circuit Judge.

This action, which arose in Colorado, seeks recovery of a statutory civil liability for failure to disclose in an automobile installment purchase contract the right of the seller to a returned and unearned insurance premium on a policy

covering physical damage insurance. The claim is made under the Truth in Lending Act, TILA, 15 U.S.C. § 1601 et seq. as implemented by Federal Reserve Board Regulation Z, 12 C.F.R. § 226. The district court granted a motion to dismiss and the plaintiffs-buyers appeal. We affirm.

The plaintiffs-appellants, Jody and Barbara James, purchased a pick-up truck from defendant-appellee Del Norte Motor Company and executed an installment purchase contract which was assigned to Ford Motor Credit Corporation. The contract shows a cash price of $5395.00, down payments of cash and trade-in totalling $900.50, and a balance due of $4,494.50. To this are added other charges consisting of $359.84 for insurance and $5.50 registration fee. Also added is a finance charge of $1,238.92, at an annual interest rate of 15.40%. The balance due is payable in monthly installments of $169.41.

Paragraph 13 of the signed face page of the contract reads:

> "Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and to the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due thereunder."

Paragraph 15 on the face page provides that the terms and conditions on the reverse side are incorporated by reference. Paragraph 18 on the reverse side relates to insurance and among other things provides:

> "Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, * * *. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the indebtedness hereunder in the sole discretion of the Seller."

TILA requires, 15 U.S.C. § 1631(a), that a creditor "clearly and conspicuously, in accordance with the regulations of the Board" disclose the information mandated by the Act. Reg. Z, 12 C.F.R. § 226.8(a) provides that all the disclosures be made on either:

> "(1) The note or other instrument evidencing the obligation on the same side of the page and above the place for the customer's signature; or
>
> (2) One side of a separate statement which identifies the transaction."

Failure to disclose properly the required information subjects the offender to a civil liability of not more than $1,000.00 plus reasonable attorneys' fees. 15 U.S.C. § 1640(a). The purchasers sue for the statutory liability and attorneys' fees. The trial court held that the assignment of the returned and unearned portion of the insurance premium was not a security interest under the Colorado version of the Uniform Commercial Code. See Colo. Rev. Stat. (1973) § 4-9-102.

TILA requires, 15 U.S.C. § 1638(a)(10), the disclosure of "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates." The Act does not define "security" or "security interest." Reg. Z provides, 12 C.F.R. § 226.2(gg):

> " 'Security interest' and 'security' mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust and [various liens and a lease interest securing performance of an obligation]."

The reference to the Uniform Commercial Code specifically declares that it is not a limitation. Although the interplay of federal and state law presents problems, the right to the TILA civil liability for nondisclosure rests on federal law. TILA is remedial legislation, designed to prevent predatory creditor practices, and must be liberally construed to effectuate the intent of Congress. See Mourning v. Family Publications Service, Inc., 411 U.S. 356, 365, and Littlefield v. Walt Flanagan and Company, 10 Cir., 498 F.2d 1133, 1136.

Three circuits have held that nondisclosure of the seller's rights to unearned and returned premiums violates TILA and subjects the seller to the statutory liability. See Gennuso v. Commercial Bank & Trust Company, 3 Cir., 566 F.2d 437; Edmondson v. Allen-Russell Ford, Inc., 5 Cir., 577 F.2d 291, cert. denied 441 U.S. 951; and Valencia v. Anderson Brothers Ford, 7 Cir., —— F.2d ——. The last of these, Valencia, was decided on March 20, 1980.

On March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act" as Title VI of the "Monetary Control Act of 1980." P.L. 96-221, 94 Stat. 132. Section 614(a) amends 15 U.S.C. § 1638(a), the disclosure section of TILA. Subsection (a)(9) reads, U.S. Cong. & Adm. News, No. 3, May 1980, 94 Stat. 179:

> "Where the credit is secured, [the creditor shall disclose to the extent applicable] a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

S. R. 96-368, U.S. Cong. & Adm. News, supra, p. 850, states the purpose of the 1980 amendments thus:

> "Despite the act's clear successes, however, there is a growing belief among consumers and creditors alike

that the act could be substantially improved. There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions. There is also evidence that many creditors have sincerely tried to comply with the act but, due to its increasing complexity and frequent changes, have nonetheless found themselves in violation and subject to litigation. In addition, this committee and other congressional and government sources have found the level of administrative enforcement by the Federal bank agencies seriously inadequate. In short, the committee believes that the interests of both consumers and creditors would be furthered by simplification and reform of the act."

With particular reference to the amendment of the disclosure requirements of § 1638(a), the Senate Report says, Id. p. 864:

"The security interest disclosure is also simplified to eliminate the technical disclosure of the type of security interest taken. When a security interest is being taken in property purchased as part of the credit transaction, this section requires a statement that a security interest has been or will be taken in the property purchased. When a security interest is being taken in property not purchased as part of the credit transaction, *the Committee intends this provision to require a listing by item or type of the property securing the transaction, but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums, rights arising

under, or waived in accord with state law, accessions, accessories or proceeds." (Emphasis supplied)

S. Rep. No. 96-73 says, Id. at 879-880:

> "The subcommittee learned that judging from consumer tests in other areas, the typical disclosure statement utilized today by creditors is not an effective communication device. Most disclosure statements are lengthy, written in legalistic fine print, and have essential truth in lending disclosures scattered among various contactual [sic] terms.
>
> The result is a piece of paper which appears to be 'just another legal document' instead of the simple, concise disclosure form Congress intended."

Ford Motor Credit Co. v. Milhollin, —— U.S. ——, 48 L.W. 4145, decided February 20, 1980, was concerned with the imposition of the statutory liability under TILA for a claimed nondisclosure of an acceleration clause. The Court concluded, 48 L.W. at 4146, that the issue of acceleration disclosure "is not governed by clear expression in the statute or regulation, and • • • it is appropriate to defer to the Federal Reserve Board and staff in determining what resolution of that issue is implied by the truth in lending enactments." The Court examined the Federal Reserve Board staff treatment of acceleration disclosure and denied imposition of the statutory liability.

We are aware of no administrative interpretations pertinent to the particular issue before us. Public Position Letter No. 377, quoted in Edmondson, 577 F.2d 295, n. 8, relates to life insurance, not physical damage insurance. Staff Letter 1263, Consumer Credit Guide (CCH) ¶ 31,736 (November 23, 1977), an unofficial interpretation, leaves to state law the question of whether a security interest has been acquired by the creditor and, if so, whether that interest has been adequately identified.

In Milhollin, supra, 48 L.W. at 4149, the Court said:

> "The concept of 'meaningful disclosure' that animates TILA (citation omitted), cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . informational overload' (citations omitted) and striking the appropriate balance is an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." (Emphasis in original).

The Milhollin approach parallels the intent of Congress in enacting the 1980 amendments and the legislative history of those amendments. The effort is to strengthen the impact of TILA by simple, concise disclosures which can be understood by consumers and creditors. The installment contract in issue identifies the security interest taken in the property purchased, the pick-up truck. The insurance charge is specifically noted on the face of the contract and is included in the total amount which must be repaid in monthly installments. The insurance on damage to the vehicle was part of the credit transaction. The right of the seller to the returned premium would seem to be part of the "proceeds" of that transaction. If not such a part, the returned premium is property not purchased. The Senate Report, supra p. 864, says with reference to property not purchased, that the disclosure need not include "a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums." We are convinced that the Act does not require, and Congress did not intend it to require, an exemplification of that interest on the face of the installment contract. Because of this conclusion, we need not delve into the legal complexities of the Third Circuit decision in Gennuso, 566 F.2d 437; the Fifth

Circuit decision in Edmondson, 577 F.2d 291; and the Seventh Circuit decision in Valencia, —— F.2d ——.

The application of Milhollin and the 1980 actions of Congress present no retroactivity problem. We are concerned only with civil liability for nondisclosure. The buyers have shown no damage. Our decision establishes no new principle of law. Rather, it recognizes the congressional intent. Application to this case furthers the operation of TILA and produces an equitable result. See Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107.

Affirmed.

No. 78-1806—JAMES v. FORD MOTOR CREDIT COMPANY, et al.

DOYLE, Circuit Judge, dissenting.

Because of my belief that the seller's right to unearned and returned premiums is a security interest, and thus the installment purchase contract here violates the Truth in Lending Act, I respectfully dissent.

The question is whether the provision in the contract which provides that the buyer assigns to the seller any monies payable under the insurance (on the car), including returned or unearned premiums, and which authorizes the seller on behalf of both parties to receive or collect same constitutes a violation of the Truth in Lending Act.

Regulation Z, 12 C.F.R. Section 226.2(gg), defines security interest as meaning "any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code. . . ."

This problem is not a new one. Three circuits have considered this issue and have held that the nondisclosure of

the seller's right to unearned and returned premiums violates the Truth in Lending Act and subjects the seller to the remedy which is being pursued here. The cases are Gennuso v. Commercial Bank & Trust Company, 566 F.2d 437 (3rd Cir. 1977); Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951; and Valencia v. Anderson Brothers Ford, —— F.2d —— (7th Cir. March 20, 1980).

The earliest of these decisions is Gennuso v. Commercial Bank & Trust Co., *supra*. Here the plaintiff charged that the Commercial Bank and Trust Company failed to properly identify in the Disclosure Statement and in the Note and Security Agreement a security interest in the proceeds and the unearned premiums in a property insurance policy covering the automobile that he had purchased. It was alleged that such failure violated the Truth in Lending Act and Regulation Z. No mention of the security interest in the insurance policy was made at the top of the note where the collateral was described. There had been some slight mention of the interest in question in the note and security agreement. It was held that the use of general language in this document was sufficient. It was said that the mention of the security interest in after-acquired property satisfied the requirements of the Act. The court held that the conduct of the bank constituted a violation of the Truth in Lending Act and Regulation Z as well.

To the same effect is Edmondson v. Allen-Russell Ford, Inc., *supra*. Here again the court held that the assignment of a returned or unearned premium of an insurance policy was a security interest for purposes of Regulation Z, in accordance with the Truth in Lending Act, and had to be disclosed. The court, through Goldberg, J., had no difficulty concluding that the unearned portion of the premium was a security interest which had to be disclosed. The court relied on Gennuso v. Commercial Bank & Trust Co., *supra*.

Here again the court ruled that it was inadequate to construe the general provision that the " 'Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof. . . .' " 577 F.2d at 295. The court said that the "lender must disclose the type of security interest held, retained, or acquired and the property of the borrower which serves or will serve as the collateral." 577 F.2d at 295. A sufficient description was determined to be essential.

The third of the recent circuit cases is Valencia v. Anderson Brothers Ford, *supra,* from the Seventh Circuit. The court said:

> We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue. In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

Slip op. at p. 14.

The majority was influenced by the fact that on March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act," which amended 15 U.S.C. Section 1638(a), the disclosure section of the Truth in Lending Act. As amended, it was pointed out by the majority that this section permits disclosure of the principal property which provides the security for the loan. It does not require, so the Report says, a listing of related or incidental interests in the property, and it gives as an example a loan secured by an automobile which is not being purchased with the proceeds of the loan, but which would require a state-

ment indicating that the loan is secured by an automobile. It would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums.

The majority also calls attention to the recent opinion of the Supreme Court in Ford Motor Credit Co. v. Milhollin, —— U.S. ——, 48 L.W. 4145, decided February 20, 1980, which adopted the approach that security documents have, in the past, carried too much excess luggage and that they should disclose with simplicity and should limit themselves to the disclosure of the matters having to do with the security itself. This may well be the present tendency, but at the time of the occurrence in question the approach which is shown by the Third, Fifth and Seventh Circuits obtained.

In summary, the automobile insurance policy and, of course, the premium which is paid to obtain the coverage, are part and parcel of the entire automobile financing business. It makes the loan more secure.[1] Thus the unearned premium which would ordinarily go to the insured and which is being held back by the lender is information of genuine interest to the purchaser-insured, and it is not possible to cause it to be unimportant.

The new approach might render the procedure less complicated. Nevertheless, I submit that we are not justified in adopting this concept so as to apply it to the present set of facts and to do so only on the basis of legislative history which attended the enactment of the amendments. Even if the legislative history would call for a different result, it should not be applied here in a retroactive way.

For the reasons stated, I disagree with the majority opinion.

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[1] If, for example, the automobile were to be stolen or totaled out in an accident, there would be no security in the absence of insurance.

ORDER OF THE COURT OF APPEALS
DENYING PETITION FOR REHEARING
(July 21, 1980)

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

JODY JAMES and BARBARA JAMES, Plaintiffs-Appellants,	)	
v.	)	No. 78-1806
FORD MOTOR CREDIT COMPANY and DEL NORTE MOTOR COMPANY, Defendants-Appellees.	)	

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(D. C. No. Civ. 78-F-647)

Before SETH, Chief Judge, BREITENSTEIN, HOLLOWAY, McWILLIAMS, BARRETT, DOYLE, McKAY, LOGAN and SEYMOUR, Circuit Judges.

PER CURIAM.

ON PETITION FOR REHEARING

The petition for rehearing is denied. The petitioners-appellants object to the consideration which the court gave to the

March 31, 1980, "Trust [sic] in Lending Simplification Act" and its legislative history. The Supreme Court has said that when two acts are in *pari materia*, the later act can be "regarded as a legislative interpretation of the earlier." *United States v. Stewart*, 311 U.S. 60, 64. In *Regents of the University of California v. Bakke*, 438 U.S. 265, 349, the separate opinion of four Justices says: "We have repeatedly recognized that subsequent legislation reflecting an interpretation of an earlier Act is entitled to great weight in determining the meaning of the earlier statute."

The 1968 and 1980 acts related to the same subject matter. "Truth in Lending." We are convinced that the 1980 Act reflects an interpreation [sic] by Congress of the earlier act and is entitled to great weight. The effect is that Congress in passing the 1968 act did not intend to impose a civil penalty for the type of nondisclosure claimed by the appellants.

Judge Doyle would grant the petition for rehearing.

The petition for rehearing having been denied by the panel to whom the case was argued and submitted and no member of the panel nor judge in regular active service on the court having requested that the court be polled on rehearing en banc. Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

JAMES SHANKS, Plaintiff, vs. GREENBRIAR DODGE, INC., Defendant.	CIVIL ACTION NO. C75-1154A

MAGISTRATE'S REPORT AND RECOMMENDATION

On April 10, 1975, James Shanks purchased an automobile from Greenbriar Dodge. He financed the transaction by entering into a consumer credit agreement with the defendant, who was a creditor within the meaning of the Consumer Creditor Protection Act, 15 U.S.C. § 1601, *et. seq.* Shanks is a natural person who borrowed the money from the defendant primarily for household and family purposes.

On June 17, 1975, Shanks, through counsel, filed a complaint charging that the defendant's contract for credit was violative of the Truth-in-Lending law, in that not all required disclosures were made thereon.

On August 24, 1976, the Honorable Ezra H. Cohen filed his recommendations as to the initial contentions. On September 10, 1976, and before the Report and Recommendation had been ruled upon by the District Court, the plaintiff filed a supplemental memorandum in support of his motion for summary judgment, raising an additional ground which is the subject of this Report and Recommendation.

In his supplemental memorandum, the plaintiff contends that the defendant retained a security interest in any un-

earned premiums paid on the insurance on the collateral. This retained right is not shown on the disclosure statement in the section which purports to list all security interests retained.

The only security interest set out in the disclosure statement is as follows:

> 13. Security Interest: Seller shall have a Security Interest, as the term is defined in the Uniform Commercial Code of the state in which this contract is executed, in the property until all amounts due under this contract are paid in full.

Item 6 of the "undisclosed" section of the "Additional Terms and Conditions" of the Security Agreement provides in part as follows:

> 6. Buyer agrees to keep the property insured at buyer's expense against substantial risks of damage, destruction, or loss for so long as any amount remains unpaid on this contract with loss payable to the seller as its interest may appear . . . the proceeds from vehicle insurance, by whomever procured, shall be applied toward replacement of the property or payment of the obligation hereunder, in the sole discretion of seller. Buyer hereby assigns to seller any monies not in excess of the unpaid balance due under this contract, that may become payable under such insurance, by whomever obtained, including return of unearned premiums and authorizes and requests any insurance company to make payment of such monies directly to seller to be applied to the unpaid balance hereunder, and buyer appoints seller as buyer's attorney-in-fact to endorse buyer's name upon check or draft representing payment to buyer of such monies.

This identical contention is made in a good number of cases presently under submission to the Magistrate. A vir-

tually identical situation has previously been submitted to the District Court in *Edmondson* v. *Allen-Russell Ford, Inc., et al.*, Civil Action No. 75-940A (N.D.Ga. 1976). In this Report and Recommendation, Judge Cohen noted in passing that he felt that the situation set out above created a security interest which ought to be disclosed. The Report and Recommendation was adopted by the Honorable Newell Edenfield as no objection was made. Apparently, Judge Cohen did not consider that case as a final disposition of the issue, for in the case *sub judice,* he issued a *WITHDRAWAL OF RECOMMENDATION* filed October 27, 1976, in which he noted that:

> Since the defendant in *Edmondson* admitted that the clause created a security interest, *Edmondson* may be distinguished from this case where there is no such admission.

From a review of the cases submitted to this Magistrate recently, it would appear that under these circumstances, most lenders in the District claim the same right in the unearned premiums which the defendant here did, and it would appear further that this fact is not disclosed as a security interest. Because of the import of the issue, a detailed analysis is in order.

Congressional intent in the legislation seems an apt point of beginning. Credit for the whole notion is given to Senator Paul H. Douglas of Illinois who first suggested the need for such a bill seven years prior to its passage in 1968. It was the Senate who first passed a Truth-in-Lending bill in 1967. That bill was passed in lieu of the House bill after substituting for its language much of the text of the House bill. The House report of the Committee on Banking and Currency said of the Truth-in-Lending portion that:

> It provides for full disclosure of credit charges, rather than regulation of the terms and conditions under

> which credit may be extended. It is the view of your committee that such full disclosure would aid the consumer in deciding for himself the reasonableness of the credit charges imposed and further permit the consumer to "comparison shop" for credit. 1968 *U.S.C. Cong and Admin News* 1963.

The Committee noted that, in speaking for the legislation, President Johnson said in part:

> The Consumer has the right to know the cost of this key item of his budget just as much as the price of any other commodity he buys. If consumers are to plan prudently, and to shop wisely for credit, they must know what it really costs. In many instances today consumers do not know the cost of credit. Charges are often stated in confusing or misleading terms. They are complicated by "add ons" and discounts and unfamiliar gimmicks. The Consumer should not have to be an actuary or a mathematician to understand the rate of interest that is being charged. As a matter of fair play to the consumer, the cost of credit should be disclosed fully and simply. *Id.* at 1965.

In listing then existing disclosure practices which the Committee condemned, it dealt only with those practices which obscured the rate of charge and the dollar cost of credit. *Id.* at 1970. In a close perusal of the House report, nowhere has this Magistrate been able to see one indicia of concern for whether or not security interests were disclosed. The Conference Committee's report does not deal with whether or not any security interest ought to be disclosed. The Conference Committee's report does, however, discuss the disclosures about which the Congress was concerned with reference to property and liability insurance. It is apparent that the conferees considered the cost of premiums for property and liability insurance to be the only item which ought to be disclosed. By compromise they reached the conclusion that under the facts of this transac-

tion, not even their cost must be itemized, disclosed, or included in the finance charge. *Id.* at 2022.[1]

Although the Act, as finally passed, and Regulation Z, as promulgated by the Federal Reserve Board, require the disclosure of retained security interest generally, it seems clear that both enacting bodies gave considerable attention to the issue of how to disclose matters pertaining to insurance purchased incident to the acquisition of credit, and neither has specifically required the disclosure which the plaintiff contends ought to have been made.

On July 22, 1970, an opinion letter issued from the Board saying that where a single premium *lifetime* accidental death and dismemberment policy was purchased out of the proceeds of the loan and where the creditor was designated as owner of the policy during the term of the loan, it would be appropriate to disclose the loan company's ownership of the policy as a type of security interest.[2]

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[1] The Conference substitute did not require disclosure of such insurance premiums if the debtor is clearly informed of his right to choose where to buy such insurance.

[2] As we understand the proposed plan, your client proposes to place literature in its loan offices concerning insurance to be sold by a company unrelated to your client. Applications for single premium lifetime accidental death and dismemberment policies are available in each office and if a customer desires to purchase such a policy with the proceeds of his loan, a check will be sent directly to the Company from your client in payment of the premium. While your client will not require the purchase of this insurance and the proceeds of the policy would in no circumstances be used to pay any portion of an unpaid balance of the loan, your client would be designated as owner of the policy during the term of the loan. In the event of the customer's default, your client would have the right to cancel the policy and apply any premium refund to the unpaid balance of the loan.

Under the circumstances, we think it would be appropriate to disclose the loan company's ownership of the policy as a type of

This Court would not read that opinion letter to make the disclosure obligatory. The use of the word "appropriate" makes the letter seem advisory in nature rather than imperative when viewed against the usual language in Board opinion letters which are noteworthy for positively setting out the agency's opinion in absolute terms.[3]

Even if the opinion letter were accorded full deference, it is not controlling of the situation here. In the hypothetical to which the Board addressed itself, the borrower purchased something of independent value whose existence was not tied to the term of the loan. It is analogous to the situation where a car purchaser also buys a boat trailer from the dealer and finances both with the loan. Clearly in that instance if the small print gives the creditor a security interest in both, that ought to be disclosed. In the hypothetical, the insurance is not taken out solely to protect the value of the collateral or the repayment ability of the borrower during the period of the loan, as is the case at hand.

The argument is made that the right of the creditor to unearned property insurance premium is not a security in-

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"security interest" under Section 226.8(b)(5), and disclosures need not be made under Section 226.4(a)(5). The amount of the premium would not be included in the "finance charge" nor would it be disclosed as an "other charge".

Tynan Smith, Assistant Director

[3] It is understood that Federal Reserve Board staff opinion letters are, "entitled to great weight" for they constitute part of the body of "informed, experience and judgment of the agency to whom Congress delegated appropriate authority." *Philbeck* v. *Timmers Chevrolet, Inc.*, 499 F.2d 971, 976 (5th Cir. 1974). But, such letters are not rules, regulations or interpretations within the meaning of 18 U.S.C. § 1640(f). See *Jones* v. *Community Loan and Investment Corp.*, slip opinion page 248, December 13, 1976 (5th Cir.); *Ives* vs. *W. T. Grant Co.*, 522 F.2d 749, 758 (2nd Cir. 1975).

terest at all. Some would contend that it is not a security instrument under the Uniform Commercial Code, and others contend that it is not a security interest under the Truth-in-Lending Act and its regulations which perhaps encompass more situations than does the Uniform Commercial Code. It is pointed out that the language of the contract gives an outright assignment of monies due the borrower from an insurance company to the lender.

The definition of "security interest" in the Uniform Commercial Code [*Ga. Code Ann.* § 109 A-1-201(37)] is in pertinent part:

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation.

Thus, a creditor's right to the property is conditioned on the status of the underlying debt.

On the other hand, "assignment" is defined, generally, as:

> A transfer or making over to another of the whole of any property, real or personal, in possession or in action, or of any estate or right therein. *Black's Law Dictionary,* Fourth Edition, 1951.

Under the conditions of the loan agreement in the case at bar, if an insurance company cancelled a policy or refused to accept the risk, which it might do for a variety of reasons, this would result in returned premiums; yet, the debt contract would still be in place so long as the debtor honored the contract by payment in accordance with its terms. Unlike the situation with a bona fide security interest, the defendant in this case has an absolute right to the returned premiums even if the debt is not in default. It is supposed that for that reason one of the commentators has noticed that:

> The following are not security interest [sic] within the definition of the Code . . . (b) an absolute assignment. An absolute assignment of money due under a contract in payment of a debt owed by the assignor is not the creation of a security interest under the Code. . . . 1 *Anderson, Uniform Commercial Code,* § 1-201:110, 2nd Edition, 1970.

It is also interesting to note that in Georgia a transfer of an interest or claim in or under any policy of insurance is not treated as a secured transaction. *Ga. Code Ann.* § 109A-9-104(f).

The fact that the "assignment" in this case may not be a security interest within the meaning of the Uniform Commercial Code, however, is not finally determinative. In Regulation Z "security interest" and "security" are defined to mean:

> Any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interest under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual and confessed liens whether or not recorded, mechanics, materialmen, artisans, and other similar liens, vendors liens in both real and personal property, the interest of the seller in a contract for sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation. 12 C.F.R. 226.2(gg).

Even under the definition contained in Regulation Z, it is not clear that the assignment in question is a security interest. The creditor has two separate considerations in this loan. The first is to obtain a security interest in the automobile which is being used as collateral. Second, he has an interest in seeing that his collateral does not become worthless because of loss, damage, or destruction. To protect the collateral, the loan agreement in a separate section requires the borrower to obtain property insurance but

ultimately gives to the lender the full power to keep the property protected, and it gives to him the right to be recompensated if ultimately he must act to protect the value of the collateral. It follows then that if the lender must act to provide the protection of collateral, he ought to be able to take advantage of such monies as have been expended by the borrower to provide this protection.

This Court is saying then that it views the assignment as giving the borrower a right to monies to be used for the protection of the collateral and that the contract rights so obtained did not come into existence primarily to create additional security for the credit. Therefore, this right of the creditor is not seen as a security interest within the meaning of that term as defined in Regulation Z and, therefore, no disclosure is required.

The Fifth Circuit recently has had an occasion to examine a credit contract much like the one here. In that case the borrower complained that the disclosure was inadequate because it did not mention the creditor's right of repossession of the collateral. In denying relief on that point, the Court noted that neither the Act nor the regulations imposed upon the creditor the obligation to set forth a list of its rights as a secured party. *Grant* v. *Imperial Motors,* 539 F.2d 506, 509 (5th Cir. 1976).

While others may posit a decision on this issue turning on whether or not this assignment is a security interest, this Magistrate is impressed with the rationale applied in the Third and Fifth Circuits in a number of recent cases dealing with acceleration causes [sic] which, it is felt, is the denouement of the instant issue also.

The birth of the rationale is ascribed by the Fifth Circuit to the case of *Johnson* v. *McCrackin-Sturman Ford, Inc.,* 527 F.2d 257 (3rd Cir. 1975). In that case the plaintiff contended and the Court below held that payments made

due by the exercise of the acceleration clause were "charges" within the meaning of the phrase, "default, delinquency, or similar charges payable in the event of late payments", which must be disclosed according to Section 226.8(b)(4) of Regulation Z. In finding to the contrary, the Court of Appeals noted that "disclosure" was a term of art under the Truth-in-Lending Act which was intended by the Congress to give the consumer a list of credit items considered important by the Congress so that he might be well equipped to choose the credit contract that best fit his needs. The Court went on to note that probably there was no installment contract in force today that did not contain a clause granting the creditor the right to require immediate payments of all installments upon the happening of a specified event. The decision assumed that the Congress intended to deal with commercial realities and found that charges of the type referred to in the Regulation meant additional amounts due beyond the disclosed indebtedness. In concluding, the Third Circuit said:

> However, no matter how desirable we might think it to underscore a creditor's right to accelerate payment upon default, the question to which we are, of course, limited is whether the specific provisions of the Truth-in-Lending Act or Regulation Z require including of this right in the disclosure statement. *Id.* at 269.

Essentially the same issue was presented to the Fifth Circuit in a trilogy of cases before a panel of Wisdom and Morgan, Circuit Judges, and Lynne, District Judge.[4] That

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[4] *Martin* vs. *Commercial Security Company, Inc.*, 539 F.2d 521 (5th Cir. 1976), *Myers* vs. *Clearwater Dodge Sales, Inc.*, 539 F.2d 511 (5th Cir. 1976), *Grant* vs. *Imperial Motors*, 539 F.2d 506 (5th Cir. 1976). But the per curiam opinion in *McDaniel* vs. *Fulton National Bank*, slip opinion page 171, December 6, 1976 (5th Cir.), decided by a different panel, seems to invite a petition for rehearing *en banc*.

panel reached the same conclusion reached in the Third Circuit and cited that Circuit's decision liberally with approval.

The key case is *Martin*. Judge Lynne, writing for a unanimous panel, began by noting that:

> The Congressional finding that "the informed use of credit results from an awareness of the cost thereof by consumers" is the principal theme of the Act. Consequently, the Act and the Regulations promulgated thereunder require the full disclosure *of certain credit terms* which Congress and the Federal Reserve Board have deemed essential to "informed use of credit". *Id.* at 523. (Emphasis added)

A page later the opinion continues in the same vein:

> While (the Act) and (the Regulations) enumerate the credit terms to be disclosed in consumer credit sales not under an open end credit plan, neither section specifically requires disclosure of the creditor's right to accelerate payment upon default, nor is there any official Board interpretation requiring such disclosure. It is highly illuminating that there is no reference in the Act, the Regulations, or the official interpretations of the Federal Reserve Board, to acceleration clauses or the right to accelerate payments, even though Congress has set forth in the Truth-in-Lending Act those credit terms it considers essential to the informed use of credit and has mandated uniformity in terminology and manner of presentment in order to assure a meaningful disclosure of such terms. It is the task of the Board armed with delegated authority, to implement the policy of the Act and not that of the Court.

The opinion concludes as follows:

> We hold that in the absence of the Regulation requiring it, failure to disclose an acceleration clause and the lender's rebate policy with respect thereto in an installment credit transaction does not give rise to a claim for statutory damages. *Id.* at 529.

The rationale then is that disclosure, as used in the Truth-in-Lending Act, means the meaningful disclosure of the specific terms set out by the Congress, and the lawful regulations and opinions of the Federal Reserve Board. It is conceded that these generally require the disclosure of security agreements. Here that is of no consequence for the Congress and the Board have given considerable study to the cost of insurance incident to the obtaining of credit and have specifically set out those disclosures which it was felt effectuated the policy of the Act. As both bodies have thoroughly considered the insurance premium issue and have not required the disclosure sought here, then this Court should not.

REPORTED AND RECOMMENDED this 10th day of December, 1976.

/s/ J. OWEN FORRESTER

J. Owen Forrester
United States Magistrate

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

JAMES SHANKS, *Plaintiff*, vs. GREENBRIAR DODGE, INC., *Defendant*.	CIVIL ACTION NO. C75-1154A

ORDER

After having carefully reviewed the Magistrate's Report and Recommendation in this case, it is received with approval.

Let a copy of this Report and Recommendation and Order be served upon counsel for the parties.

If no objection is made within ten (10) days of this Order the Magistrate's Report and Recommendation will be adopted as a record of the proceedings below and as the opinion and Order of the Court.

SO ORDERED this 16th day of December, 1976.

CHARLES A. MOYE, JR.
Charles A. Moye, Jr.
United States District Judge

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 78-2562

GLENN A. SOUIFE,

Plaintiff-Appellant,

vs.

FIRST NATIONAL BANK OF COMMERCE,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Louisiana

ON PETITION FOR REHEARING EN BANC

(December 5, 1980)

Before THORNBERRY, ANDERSON, AND THOMAS A. CLARK,

Circuit Judges.

PER CURIAM:

The court will defer further consideration of the petition for rehearing en banc pending decision by the Supreme Court in *Anderson Bros. Ford* v. *Valencia,* 617 F.2d 1278 (7th Cir.), *cert. granted,* 48 L.W. 2654 (November 11, 1980) (No. 80-84).

ENTERED FOR THE COURT:

/s/ R. Lanier Anderson, III
United States Circuit Judge

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; FC-0173]

TRUTH IN LENDING

Proposed Official Staff Interpretation

AGENCY:

Board of Governors of the Federal Reserve System.

ACTION:

Proposed official staff interpretation.

SUMMARY:

In accordance with 12 CFR 226.1(d)(2), the Board staff is publishing for comment official staff interpretation FC-0173 of Regulation Z, Truth in Lending, regarding security interest disclosures in closed end credit transactions. The proposed interpretation holds that a creditor need not disclose as a security interest its right to receive insurance proceeds or unearned premiums nor does it need to disclose that it is named as loss payee or beneficiary on an insurance policy.

DATES:

Comments must be received on or before October 20, 1980.

ADDRESS:

Comments (including reference to FC-0173) may be mailed to Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Wash-

ington, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT:

Claudia J. Yarus, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3667).

SUPPLEMENTARY INFORMATION:

(1) The text of official staff interpretation FC-0173 is published with identifying details deleted to the extent required to prevent a clearly unwarranted invasion of personal privacy. The Board maintains and makes available for public inspection and copying a current index providing identifying information for the public, subject to certain limitations stated in 12 CFR Part 261.6.

(2) The letter is being issued as a proposal, rather than in final form, and interested persons are invited to submit relevant comment.

(3) After comments are considered, this official staff interpretation may be amended, may be withdrawn or may remain unchanged. Final action regarding this official staff interpretation will appear in the *Federal Register*.

(4) Authority: 15 U.S.C. 1640(f).

---

§ 226.2(gg) Creditor is not required to disclose as a security interest its right to receive insurance proceeds or unearned insurance premiums nor to disclose that it is named as loss payee or beneficiary on an insurance policy.

§ 226.8(b)(5) " " "

This is in response to your letter requesting an official staff interpretation regarding security interest disclosures under § 226.8(b)(5) of Regulation Z. You wish to know

whether the creditor's right to receive proceeds or unearned premiums from a property or a credit life insurance policy must be disclosed as a security interest. You also ask if a security interest should be disclosed where a creditor requires that it be named as the loss payee on a property insurance policy or as the beneficiary on a credit insurance policy.

Section 226.8(b)(5) addresses disclosure of security interests in other than open end credit transactions. It requires disclosure of the type of security interest taken and identification of the property to which that interest relates.

The staff believes that a creditor is not required by this section to disclose its right to receive insurance proceeds or unearned insurance premiums nor to disclose that it is named as loss payee or beneficiary on an insurance policy. Truth in Lending disclosures are meant to provide useful information to consumers to enhance credit shopping. Consumers do need to know that they risk the loss of certain property if they default. The disclosures under § 226.8(b)(5) inform consumers of which property is subject to that risk at the time the credit decision is being made. We believe that information regarding the creditor's interest in insurance proceeds and unearned premiums would not be used in comparison shopping. Although a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums, it is our opinion that such incidental interests are not the type of interests meant to be covered by § 226.8(b)(5).

The staff recognizes that there are a number of circuit court decisions to the contrary. We believe, however, that our position better serves the purpose of the statute and the regulation to convey in a meaningful way information that can be used by consumers in shopping for credit.

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(2). It is limited to the facts and issues discussed herein.

Sincerely,

JANET HART
Director

Board of Governors of the Federal Reserve System, September 18, 1980.

(signed) THEODORE E. ALLISON
Theodore E. Allison
Secretary of the Board

[SEAL]

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; FC-0173]

TRUTH IN LENDING

Proposed Official Staff Interpretation; Deferral of Final Action

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Deferral of final action.

SUMMARY: By notice published on September 24, 1980 (45 FR 63295), the Board staff requested comment on proposed Official Staff Interpretation FC-0173 of Regulation Z, Truth in Lending, regarding security interest disclosures in closed end credit transactions. The comment period ended on October 24, 1980. In light of the Supreme Court's grant of certiorari in *Anderson Bros. Ford* v. *Valencia, cert. granted,* 49 USLW 3350 (1980) (No. 80-84, 1980 Term), the staff believes it is inappropriate to take final action on the interpretation at this time.

FOR FURTHER INFORMATION CONTACT:

Claudia J. Yarus, Staff Attorney,
Division of Consumer and Community Affairs,
Board of Governors of the Federal Reserve System,
Washington, D.C. 20551 (202-452-3667).

Board of Governors of the Federal Reserve System, December 15, 1980.

Theodore E. Allison,
Secretary of the Board.

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD AND
FORD MOTOR CREDIT COMPANY, *Petitioners,*

v.

OLGA VALENCIA AND
MIGUEL GONZALEZ, *Respondents.*

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF OF THE RESPONDENTS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-84

ANDERSON BROS. FORD AND
FORD MOTOR CREDIT COMPANY, *Petitioners,*
v.
OLGA VALENCIA AND
MIGUEL GONZALEZ, *Respondents.*

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF OF THE RESPONDENTS

QUESTIONS PRESENTED

1. Under the Truth in Lending Act and Regulation Z, is an assignment of returned or unearned insurance premiums a "security interest" requiring disclosure on the face of an automobile retail installment sales contract?

2. Since the Petitioners concede that Respondents should recover if Respondents prevail on the merits, have the Petitioners failed to present a case or controversy with regard to their request for prospective-only application as to parties not before the Court?

3. Should Petitioners be liable to the extent prescribed by the Truth in Lending Act when: (a) Congress has in that Act made its own determination of when liability should exist and Petitioners can assert none of the equitable defenses Congress has created; and (b) Petitioners have failed to satisfy any of the criteria for prospective-only application?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	I
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	iii
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	3
ARGUMENT	6
I. Ford Credit Retained a Security Interest in Required Physical Damage Insurance Premiums That Must be Disclosed Under the Act	6
A. The Act And Regulation Z Require Disclosure Of Any Security Interest	6
B. Ford Credit's Claim To Returned Insurance Premiums Is A Security Interest Because It Is An Interest In Property Which Secures Payment Or Performance Of An Obligation	9
C. Since 1970 FRB Public Information Letter No. 377 Has Required The Disclosure Of A Creditor's Claim On Refunded Insurance Premiums As A TILA Security Interest; A Recent Board Statement Assumes The Same Requirement	16
D. The Disclosure Of A Security Interest In Required Insurance Is Significant And Meaningful To Consumers, Thereby Promoting The Purposes of TILA	18
II. Ford Credit's Reliance on Statutory Amendments Intended to Apply to Future Transactions is Misplaced	23
A. Congress Intended The Simplification Act To Have Only Prospective Application	24
B. The Simplification Act Changes The Prior Law And Thus Does Not Interpret The Intent Of Congress In Adopting The TILA In 1968	25
C. A Statement By Senator Garn In 1980 Does Not Reflect The Intent Of The Congress Which Passed The TILA In 1968, When Senator Garn Was Not In Congress	26

Table of Contents Continued

Page

III. An Unadopted Federal Reserve Board Interpretation is Entitled to no Deference, Weight or Consideration by This Court 28

IV. There is no Case or Controversy as to Ford Credit's Request that This Court Not Apply Its Decision "Retroactively" to Litigants Other Than the Respondents in This Case 32

V. In the Truth in Lending Act Congress Has Made Specific Provision For Limits on Liability for Violations. This Legislation Pre-Empts Any Analysis That Would Otherwise be Made Under *Chevron Oil Co.* v. *Huson* 35

VI. Even Under the Chevron Test the Ruling of This Court Should Not Be Prospective Only 37

A. This Court's Ruling For The Respondents Will Not Establish A New Principle Of Law 37

B. Petitioners Have Failed To Demonstrate That Normal Application Of The Decision Will Retard Operation Of The Security Interest Disclosure Rule Of The TILA 40

C. No Inequity Is Imposed On Any Creditor By Following The General Rule That Judicial Decisions Apply To Pending Cases And Cases Brought Within The Statute Of Limitations ... 42

CONCLUSION 47

ADDENDUM

Federal Reserve Board Press Release, November 28, 1980 ..... 1a

Ford Credit Illinois Automobile Retail Installment Contract 3a

Federal Reserve Board mailing, November 24, 1980 ... 5a

TABLE OF AUTHORITIES

CASES: Page

Administrator, Federal Aviation Administration v. Robertson, 422 U.S. 255 (1975) 8, 18

Alabama State Federation of Labor v. McAdory, 325 U.S. 450 (1945) 34

American Book Co. v. Kansas, 193 U.S. 49 (1904) 34

Brown v. Termplan, Inc., 459 F.Supp. 160 (N.D. Ga. 1978) 42

Bulger v. Thorpe Credit, Inc., 609 F.2d 1255 (7th Cir. 1979) 21, 39

Caminetti v. United States, 242 U.S. 470 (1917) 8

Cannon v. University of Chicago, 441 U.S. 677 (1979) 36, 37

Cash v. Califano, 621 F.2d 626 (4th Cir. 1980) 44

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 6, 35, 36, 37, 38, 39, 40, 42, 43

Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1939) 33

Cipriano v. City of Houma, 395 U.S. 701 (1969) 33, 43

City of Los Angeles v. Manhart, 435 U.S. 702 (1978) ... 36, 37, 42

Consumer Product Safety Commission v. GTE Sylvania, Inc., ___ U.S. ___, 64 L.Ed. 2d 776 (1980) . 27, 28, 32

De La Rama S.S. Co. v. United States, 344 U.S. 386 (1953) 24

Desist v. United States, 394 U.S. 244 (1969) 37

Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957 (5th Cir. 1976) 15

Ector v. Southern Discount Co., No. C78-899A (N.D. Ga. 1980) 14, 43

Edmondson v. Allen-Russell Ford, Inc., No. C75-940A (N.D. Ga. April 29, 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) . 11, 13, 14, 15, 18, 38, 39

Elzea v. National Bank of Georgia, 570 F.2d 1248 (5th Cir. 1978) 11

Table of Authorities Continued

Page

Ferguson v. Centran Bank of Akron, CCH Cons. Cred. Guide ¶97,292 (D. Ohio 1980) 14

Flast v. Cohen, 392 U.S. 83 (1968) 34

Ford Motor Credit Co. v. Milhollin, 444 U.S. 555 (1980) . 20, 22, 23, 26, 30, 31, 32

General Electric v. Gilbert, 429 U.S. 125 (1976) 31

Gennuso v. Commercial Bank & Trust Co., 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd* 566 F.2d 437 (3rd Cir. 1977) 14, 21, 38, 39

Gilbert v. Wood Acceptance Co., 486 F.2d 627 (7th Cir. 1973) 17

Gooch v. United States, 297 U.S. 124 (1936) 15

Gosa v. Mayden, 413 U.S. 665 (1973) 42

Great Northern R. Co. v. Sunburst Oil & Refining Co., 287 U.S. 358 (1932) 40

Hagler v. Ford Motor Credit Co., 381 So.2d 80 (Ala. App. 1980) 14

Hanover Shoe, Inc. v. United Shoe Machine Corp., 392 U.S. 481 (1968) 37

Harrison v. PPG Industries, Inc., 446 U.S. 578 (1980) ..7, 15

Hernandez v. O'Neal Motors, 480 F.Supp. 491 (D.N.M. 1979) *rev'd* No. 79-2322 (10th Cir. June 24, 1980) *pet. for cert. filed sub nom* James v. Ford Motor Co., ___ U.S. ___ 11, 19

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International Brotherhood of Teamsters v. United States, 431 U.S. 342 (1977) 27

James v. Ford Motor Credit, ___ F.2d ___ (10th Cir. 1980) 26

Jimenez v. Weinberger, 523 F.2d 689 (7th Cir. 1975) *cert. denied,* 427 U.S. 912 (1976) 36, 41, 43

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Kessler v. Associates Financial Serv. Co., 573 F.2d 577 (9th Cir. 1977) 42, 43

Table of Authorities Continued

Page

Lemon v. Kurtzman, 411 U.S. 192 (1973) 36, 43

Lewis v. Walker Thomas Furniture Co., Inc., 416 F. Supp. 514 (D.D.C. 1976) 17

Linkletter v. Walker, 381 U.S. 618 (1965) 33-34, 40

Local No, 8-6 v. Missouri, 361 U.S. 363 (1960) 34

Luczak v. General Motors Acceptance Corp., 494 F.Supp. 210 (W.D.N.Y. 1980) 13, 14, 21, 22, 24

McDaniel v. Fulton National Bank, 571 F.2d 948 (5th Cir. 1978) 43

Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1976) 22, 42

Mitchell v. W. T. Grant Co., 416 U.S. 600 (1974) 9

Morton v. Ruiz, 415 U.S. 199 (1974) 31

Mourning v. Family Publications Service, Inc., 411 U.S. 356 (1973) 20, 22, 41, 44

Mullen v. North Pacific Bank, 610 P.2d 949 (Wash. App. 1980) 14

Murphy v. Ford Motor Credit Co., 629 F.2d 556 (8th Cir. 1980) 14, 24, 40

National Labor Relations Board v. Bell Aerospace Company Division of Textron, Inc., 416 U.S. 267 (1974) 28

National Wood-Work Manufacturers Association v. National Labor Relations Board, 386 U.S. 612 (1967) . 27

North Carolina v. Rice, 404 U.S. 244 (1971) 33

Philbeck v. Timmers Chevrolet, Inc., 499 F.2d 971 (5th Cir. 1974) 17

Price v. Forest, 173 U.S. 410 (1899) 18

Quern v. Mandley, 436 U.S. 725 (1978) 27

Ramirez Leal & Co. v. City Demonstration Agency, 549 F.2d 97 (9th Cir. 1977), *pet. for rehearing denied,* 549 F.2d 156 (9th Cir. 1977) 15

Red Lion v. Federal Communications Commission, 395 U.S. 367 (1979) 28

Regents of University of California v. Bakke, 438 U.S. 265 (1978) 28

Table of Authorities Continued

Page

Regional Rail Reorganization Act Cases, 419 U.S. 102 (1974) 27

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Richardson v. Ramirez, 418 U.S. 24 (1974) 33

Rounds v. Community National Bank, 454 F.Supp. 883 (S.D.Ill. 1978) 14

S & E Contractors v. United States, 406 U.S. 1 (1972) .. 7

Seatrain Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572 (1980) 28

Shanks v. Greenbriar Dodge, Inc., No. 75-1154A (N.D. Ga. 1976), *rev'd* 577 F.2d 296 (5th Cir. 1978) . 8, 39, 40

Shea v. Vialpando, 416 U.S. 251 (1974) 4, 7

Skidmore v. Swift and Co., 323 U.S. 134 (1944) 31, 32

Sneed v. Beneficial Finance Co., 410 F.Supp. 1135 (D.Hawaii 1976) 43

Souife v. First National Bank of Commerce, 628 F.2d 480 (5th Cir. 1980) 11, 14, 24, 25

Southeastern Community College v. Davis, 442 U.S. 397 (1979) 8

Stovall v. Denno, 388 U.S. 293 (1967) 34

Tehan v. Shott, 382 U.S. 406 (1966) 42

Tennessee Valley Authority v. Hill, 437 U.S. 153 (1978) . 8

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Touche Ross & Co. v. Redington, 422 U.S. 560 (1979) 36, 37

Travis v. Trust Co. Bank, 621 F.2d 148 (5th Cir. 1980) 11, 42

United States v. Peltier, 422 U.S. 531 (1975) 43

United States v. Plesha, 352 U.S. 202 (1957) 25

United States v. United Mineworkers of America, 330 U.S. 258 (1947) 27

United States v. Wise, 370 U.S. 405 (1962) 27

Table of Authorities Continued

Page

Valencia v. Anderson Bros. Ford, 617 F.2d 1278 (7th Cir. 1980) (J.A. 49) ..... *passim*

STATUTES:

1 U.S.C. §109 ..... 5, 24

Consumer Credit Protection Act., 15 U.S.C. §1601 et seq., ... 2

15 U.S.C. §1601 20

15 U.S.C. §1601(a) 18

15 U.S.C. §1605(c) 8

15 U.S.C. §1610(d) 44

15 U.S.C. §1631 7

15 U.S.C. §1635 8

15 U.S.C. §1638(a)(10) 3, 7, 8, 25, 31, 38

15 U.S.C. §1640(a) 35

15 U.S.C. §1640(a)(2)(A) 3, 35, 46

15 U.S.C. §1640(a)(2)(B) 35, 46

15 U.S.C. §1640(e) 35

15 U.S.C. §1640(f) 35

15 U.S.C. §1640(h) 44

42 U.S.C. §1983 36

Truth-in-Lending Simplification and Reform Act, Pub. L. 96-221, Title VII, 94 Stat. 168 ..... 18, 23

Ill. Rev. Stat., ch. 26, §1-201(37) 12

Ill. Rev. Stat., ch. 26, §9-101 et seq., ... 12

Ill. Rev. Stat., ch. 26, §9-102(2) 12

Ill. Rev. Stat., ch. 26, §9-306 12

Ill. Rev. Stat., ch. 26, §9-312 12

REGULATION Z AND FEDERAL RESERVE BOARD INTERPRETATIONS:

Regulation Z, 12 C.F.R. §226 *et seq.* 1980 2

12 C.F.R. §226.1(d) 43

Table of Authorities Continued

Page

Federal Reserve Board Official Interpretation, 12 C.F.R. §226.202 (1969) 9

12 C.F.R. §226.2(gg) 4, 9, 11, 13, 14, 15, 38

12 C.F.R. §226.6(a) 20

12 C.F.R. §226.8(a) 2, 4, 7, 20

12 C.F.R. §226.8(b)(5) 3, 7, 9, 16, 38

Federal Reserve Board Public Information Letter No. 377 [1969-1974 Transfer Binder] CONS. CREDIT GUIDE (CCH) ¶30,555 (July 22, 1970) 9, 16, 43

Federal Reserve Board Public Information Letter No. 827 [1969-1974 Transfer Binder] CONS. CREDIT GUIDE (CCH) ¶21,149 (August 14, 1974) 9

Federal Reserve Board Public Information Letter No. 846 [1969-1974 Transfer Binder] CONS. CREDIT GUIDE (CCH) ¶31,169 (October 9, 1974) 9

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Federal Reserve Board Proposed Official Staff Interpretation FC-0173, 45 Fed.Reg. 63295 (September 24, 1980) 28

Federal Reserve Board Press Release, November 28, 1980 (Add. 1) 18

Federal Reserve Board Notice of Deferred Action 45 Fed.Reg. 84074 (December 22, 1980) 29

Federal Reserve Board Mailing, November 24, 1980, (Add. 3) 29

CONGRESSIONAL MATERIALS:

114 Cong. Rec. 1611 (1968) 7

125 Cong. Rec.S. 4990 (1979) 27

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Table of Authorities Continued

Page

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F.T.C. v. Ford Motor Credit Company, F.T.C. Docket No. 9073 (1978) 13

Federal Trade Regulation Rule: Credit Practices, 16 C.F.R. Par. 444, Public Record 215-42, August, 1978 ..... 13, 46

Ford Motor Credit Company Form 10-K, Securities Exchange Commission, fiscal year ending December 31, 1979, Commission File No. 1-6368 46

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-84

ANDERSON BROS. FORD AND
FORD MOTOR CREDIT COMPANY, *Petitioners,*

v.

OLGA VALENCIA AND
MIGUEL GONZALEZ, *Respondents.*

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF OF THE RESPONDENTS

STATEMENT OF THE CASE

The respondent Olga Valencia purchased a used 1974 Ford Pinto from Anderson Bros. Ford on September 30, 1977. Respondent Miguel Gonzalez, her brother-in-law, co-signed for the purchase. The sale was made on a credit basis pursuant to a retail installment contract which Anderson Ford simultaneously executed and assigned to Ford Credit. The price of the automobile was $2340. Valencia paid $1000 as a downpayment and financed the remainder in 24 monthly installments commencing November 2, 1977. The finance charge was $319.84.

The front page of the contract set out certain credit information required by the Consumer Credit Protection Act, 15 U.S.C. §1601 *et seq.*, commonly known as the Truth in Lending Act ("TILA" or the "Act"), and by Regulation Z, 12 C.F.R. §226 *et seq.* All required disclosures must be on the front side. 12 C.F.R. §226.8(a). The reverse side of the contract contained form provisions in paragraph 17 requiring that the buyer purchase physical damage insurance for the automobile.[1] One day after signing the contract, Valencia independently purchased a one-year policy of this required insurance for a premium of $215.[2] (R. No. 33, Exh. 19).

Paragraph 17 also provided that the buyer assigned any returned or unearned physical damage insurance premiums to Ford Credit. Returned premiums are those which are prepaid but unearned by the insurance company because the insurance is terminated, for whatever reason, before the completion of the term of insurance covered by the premium.

---

[1] Physical damage insurance protects the automobile from damage caused by collision, theft, fire and other hazards. It may also be referred to as "collision and comprehensive insurance" or "casualty insurance," and is separate from liability insurance.

[2] The $442 figure referred to by the court below (J. A. 40), included a charge for liability insurance.

Returned premiums are normally refundable to the purchaser. Because of paragraph 17, however, they are paid to Ford Credit and "shall be applied toward replacement of the Property [defined in the contract as the vehicle] or payment of the indebtedness hereunder in the sole discretion of" Ford Credit. The front page of the contract purportedly discloses the security interests retained by Ford Credit (Contract, ¶12), but contains no reference to the security interest in the insurance premiums.

The respondents filed a complaint against Ford Credit alleging violations of TILA for failure to disclose the security interest in the insurance premiums. The District Court entered summary judgment for the respondents in the amount of $639.68 each.[3] The Court of Appeals for the Seventh Circuit affirmed, holding:

> [A]n assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue. (J.A. 51).

SUMMARY OF ARGUMENT

1. In 1977 the respondents purchased a used automobile pursuant to a retail installment contract. The Ford Credit form contract included, on its reverse side, a clause assigning to itself any returned physical damage insurance premiums.

The Truth in Lending Act ("TILA") and implementing regulations ("Regulation Z") require that "any security interest" held or to be retained by the creditor must be disclosed. 15 U.S.C. §1638(a)(10); 12 C.F.R. §226.8(b)(5). The

---

[3] The Act establishes statutory damages in individual actions in the amount of twice the finance charge, with a $100 minimum and $1000 maximum award for the consumer. 15 U.S.C. §1640(a)(2)(A).

Regulation Z definition of security interest applies to "any interest in property which secures payment . . ." No exceptions are made to the disclosure of "any security interest"; the use of the word "any" in the Act and Regulation Z makes a limited construction of these provisions inappropriate. *Shea v. Vialpando,* 416 U.S. 251, 258 (1974).

Ford Credit's claim to returned insurance premiums constitutes a security interest under TILA and Regulation Z because it is an "interest in property which secures payment or performance of an obligation." 12 C.F.R. §226.2(gg). As such, it must be disclosed on the front of the contract, 12 C.F.R. §226.8(a). Because Ford Credit ordinarily uses the returned premium (after the consumer defaults) for application to the outstanding debt, Ford Credit's property interest "secures payment."

The size of Ford Credit's interest may vary, but returned insurance premiums are often hundreds of dollars — a significant sum to the consumer. The claim to returned insurance premiums is a valuable economic right for the creditor; it provides an attractive form of liquid security which may be expeditiously obtained.

In 1970 the Federal Reserve Board ("FRB") issued a Public Information Letter which required disclosure, as a security interest, of a creditor's claim to returned insurance premiums. This ruling, and other consistent FRB pronouncements requiring disclosure are entitled to substantial deference.

Consumers would benefit from the proper disclosure of Ford Credit's security interest. Disclosure would facilitate the Act's goals of informed use of credit and comparison shopping, and allow consumers to recognize instances where returned premiums are not properly credited to a debt. The disclosure of this security interest can be made concisely and meaningfully. Indeed, many creditors have long done so and Ford Credit's new contract discloses the security interest in five words.

Ford Credit argues that this case should be decided in accordance with the Truth in Lending Simplification and Reform Act ("Simplification Act"), which is not effective until 1982. Congress did not give this revision of TILA retroactive effect. Since the Simplification Act specifically does not release creditors from liability for violations of the Truth in Lending Act occurring prior to the effective date of the amendments, 1 U.S.C. §109 also operates to preclude the extinguishment of Ford Credit's liability.

Nothing in the Simplification Act or its committee reports suggests that it purports to interpret the existing TILA. Congress intended to change prospectively security interest and other disclosure requirements. Ford Credit relies on a single statement by one legislator for the proposition that the Simplification Act amendments reflect Congress' intent in passing TILA in 1968. The statement, however, contradicts the committee report and the legislator was not a member of Congress at the time TILA was enacted.

Ford Credit also relies on an unadopted, proposed FRB staff interpretation, FC-0173, which the FRB has stated "may not be relied upon until final action is taken." The FRB released proposed FC-0173 with a request for comments and a warning that it was being issued merely as a proposal rather than in final form. The FRB recently deferred further consideration of the unadopted FC-0173. Ford Credit has offered no authority or logical basis for relying on unadopted agency proposals, particularly where the agency has precluded reliance.

2. Ford Credit argues that a ruling for the respondents on the merits should be given only "prospective" application, except as to the two respondents in this case. Presented in this posture, there is no case or controversy as to the issue of nonretroactive application of the decision. The express concession that the respondents should recover damages, regardless of the scope of application of the decision, destroys any adversarial relationship on this issue. Ford Credit seeks only an advisory opinion.

3. Even if this Court finds that a case or controversy exists, Ford Credit's attempt to apply the rule of *Chevron Oil Co.* v. *Huson,* 404 U.S. 97 (1971), is inappropriate. Where Congress mandates liability and carves out specific exceptions grounded in reliance and equitable considerations, resort to *Chevron* analysis is unnecessary and improper. In TILA Congress has set explicit damage recovery amounts and balanced equitable and reliance factors through inclusion of ceilings on damage awards, a brief statute of limitations, and an affirmative defense for creditors based on good-faith reliance on Federal Reserve Board rulings. The congressional adjustments of equitable and reliance considerations pre-empt application of *Chevron* principles.

Should the Court analyze the prospective-only issue under *Chevron* Standards, Ford Credit has failed to meet the burdens necessary to obtain prospective-only application. A decision for respondents would not represent a new principle of law. The Act, Regulation Z, the Federal Reserve Board and numerous Court of Appeals rulings have consistently required the disclosure Ford Credit here seeks to avoid. Nor has Ford Credit demonstrated that a retroactive application of the rule in this case will retard operation of the rule of the Truth in Lending Act. Finally, a normal application of the decision in this case will not produce substantial inequitable results. The effects on creditors will be minimal. Few lawsuits are pending and creditors who have changed their contracts in light of four Circuit Courts of Appeals rulings will, as a result of the Act's one-year limitations period, experience little or no additional exposure to liability.

ARGUMENT

I. Ford Credit Retained a Security Interest in Required Physical Damage Insurance Premiums That Must Be Disclosed Under The Act and Regulation

A. THE ACT AND REGULATION Z REQUIRE DISCLOSURE OF ANY SECURITY INTEREST.

Under TILA and Regulation Z, credit terms must be disclosed clearly, conspicuously and in meaningful sequence on

the front side of a contract. 15 U.S.C. §1631; 12 C.F.R. §226.8(a). One of the credit terms which must be so disclosed is "*any security interest* held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates." 15 U.S.C. §1638(a)(10) (emphasis added). *See also* 12 C.F.R. §226.8(b)(5) (Ford Brief at 2).

There are no exceptions in the statute or regulation to the requirement to disclose "any security interest." Where the word "any" is used, it is inappropriate to read a limiting construction into the statute. *Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 589 (1980); *Shea* v. *Vialpando*, 416 U.S. 251, 258 (1974) (". . . the words 'any expenses' . . . mean . . . 'all actual expenses.' ").

Ford Credit attempts to ignore the plain language of the Act and the Regulation and to distinguish between what it calls "the real 'security,' " (*i.e.*, second mortgages on consumers' houses and "the financed automobile,") and all other security interests. The sole basis for the distinction is a statement by Congressman Cahill that the "primary reason for disclosure of security interests was the 'secondary mortgage scheme.' " 114 Cong.Rec. 1611 (1968). A legislator's generalized statement concerning a "primary" function of a bill does not preclude other functions, including those specified by the statute on its face.[4] Ford Credit tries to temper the absurdity of the result of its argument (that only second mortgages need be disclosed) by conceding the need also to disclose the security interest in the item purchased. To achieve consistency with its over reliance on Congressman Cahill's general statement, Ford Credit then asserts that "the automobile purchased by the Buyers is analogous to a home . . ." Ford Brief at 13. Under the most cursory analysis the analogy falls apart.

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[4] *See, S & E Contractors* v. *United States*, 406 U.S. 1, 13 n.9 (1972): "In construing laws we have been extremely wary of testimony before committee hearings and of debates on the floor of Congress save for precise analyses of statutory phrases by the sponsors of proposed laws." Congressman Cahill's statement was not a precise analysis of the amendment.

In addition, if 15 U.S.C. §1638(a)(10) were meant to be limited to only "essential" security interests or second mortgages, it would have been drafted in that manner. In TILA, for example, there is a three day right of contract rescission, but only in those transactions in which a security interest is taken in the consumer's dwelling. 15 U.S.C. §1635. In contrast, the plain language of 15 U.S.C. §1638(a)(10) is not limited to a particular security interest; it requires disclosure of "any security interest . . ." The starting point in construing a statute is the language of the statute itself. *Southeastern Community College* v. *Davis,* 442 U.S. 397, 405 (1979). "Where the language is plain and admits of no more than one meaning, the duty of interpretation does not arise . . ." *Caminetti* v. *United States,* 242 U.S. 470, 475 (1917). *See also Tennessee Valley Authority* v. *Hill,* 437 U.S. 153, 184 n.29. (1978) and cases cited therein.[5]

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[5] Ford Credit's other attempt to avoid the plain language of the statute and regulation constructs an erroneous implication from 15 U.S.C. §1605(c). Under that provision charges for required physical damage insurance purchased in the contract must be included in the finance charge, unless there is a written disclosure stating the cost, and notice that the insurance may be purchased through a person of the consumer's choice. Ford Credit argues from this provision that there was no legislative intent to require disclosure of security interests in the premiums. Brief at 10. Its only support for this position is *Shanks* v. *Greenbriar Dodge, Inc.,* No. 75-1154A (N.D. Ga. 1976), which was reversed at 577 F.2d 296 (5th Cir. 1978). The purpose of 15 U.S.C. §1605(c), requiring inclusion of the cost of credit and physical damage insurance premiums in the finance charge, was to make certain that all creditors used the same method in computing finance charges and that the creditors did not disclose a low annual percentage rate while earning a higher rate through additional fees. H.R. Rep. No. 1040, 90th Cong., 1st Sess. (1967) *reprinted* in [1968] U.S. Code Cong. & Ad. News 1962, 1970. The security interest disclosure used different language in a separate provision for a distinct purpose. 15 U.S.C. §1638(a)(10). There is no inconsistency in the separate disclosures. It is axiomatic that all parts of an act, if possible, are to be given effect. *Administrator, Federal Aviation Administration* v. *Robertson,* 422 U.S. 255, 261 (1975). Even when the insurance charges must be included in the finance charge, if there is a security interest retained in them it must be disclosed.

Ford Credit also suggests that there can be no security interest in returned premiums because "the property interests in the policy are at least joint" between the creditor and debtor. Ford Brief, 13. The same situation exists, however, with respect to the goods purchased under the contract. *Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600, 604 (1974). Ford Credit's argument is a concession that there is a security interest because its claim to a "joint" property interest in the returned premiums exists solely by dint of the fact that it has taken a security interest in them.

Ford Credit's position in this case is also inconsistent with the federal regulation and numerous pronouncements of the Federal Reserve Board (hereafter "FRB" or the "Board") that require the disclosure of security interests not only in the item purchased and the consumer's home, but in any property, including returned insurance premiums. *See* 12 C.F.R. §226.2(gg) (extensive list of security interests); FRB Public Information Letter No. 377 [1969-1974 Transfer Binder] Cons. Cred. Guide (CCH) ¶30,555 (July 22, 1970) (security interest in returned insurance premiums). *See also* 12 C.F.R. §226.8(b)(5) (after-acquired property); FRB Official Interpretation, 12 C.F.R. §226.202 (1969) (confession of judgment clause); FRB Public Information Letter No. 827 [1969-1974 Transfer Binder] Cons. Cred. Guide (CCH) ¶31,149 (August 14, 1974) (pledged savings account balance); and FRB Public Information Letter No. 846 [1969-1974 Transfer Binder] Cons. Cred. Guide (CCH) ¶31,169 (October 9, 1974) (pledged shares in credit union account).

B. FORD CREDIT'S CLAIM TO RETURNED INSURANCE PREMIUMS IS A SECURITY INTEREST BECAUSE IT IS AN INTEREST IN PROPERTY WHICH SECURES PAYMENT OR PERFORMANCE OF AN OBLIGATION.

Ford Credit's contract includes, on its reverse side, a clause assigning to itself any returned physical damage insurance premiums. Contract, ¶17. The scope and impact of the clause is extremely broad. It applies to refunds of such insurance

purchased from the auto dealer or purchased independently by the consumer prior to, coincident with, or subsequent to the auto sale. It also authorizes Ford Credit to obtain the returned premiums whether the insurance is cancelled by Ford Credit, the buyer or the insurance company. The clause reserves use of such monies, which would otherwise be payable to the buyer, exclusively to Ford Credit.

Upon exercise of the clause and receipt of the funds, Ford Credit must apply the refunded monies toward the payment of the consumer's debt or replacement of the automobile. Contract, ¶ 17.[6] The clause is most commonly invoked upon repossession, when the creditor cancels the insurance and applies the returned premiums to the outstanding debt in the same manner as the proceeds of other secured property.

Regulation Z defines a security interest, for purposes of TILA disclosures:

> *"Security interest" and "security" means any interest in property which secures payment or performance of an obligation.* The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's and other similar liens, vendor's

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[6] Ford Credit's argument is in great part based on mischaracterization of its own contract. The premium refund clause serves as additional security for Ford Credit and not, as suggested by Ford Credit (Brief at 4), as a means to provide uninterrupted insurance. Paragraph 17 of the contract specifies that returned premiums must be used either (1) toward replacement of the "Property," defined on the contract's front page as the vehicle, or (2) toward the underlying indebtedness. Contrary to Ford Credit's assertion, the clause is not needed for protection from a risk of uninsured collateral; other provisions of the contract assure the continued existence of physical damage insurance coverage. Paragraph 17 authorizes Ford Credit to obtain replacement insurance if the necessity arises and to be reimbursed by the buyer for the expenditure. Paragraph 18 permits Ford Credit to accelerate the unpaid balance and to repossess the auto if the buyer allows the insurance to lapse.

> liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation. 12 C.F.R. §226.2(gg) (emphasis supplied).

Regulation Z thus establishes a two-pronged test for determining whether a security interest has been created: (1) "any interest in property which (2) secures payment or performance of an obligation." *Elzea* v. *National Bank of Georgia,* 570 F.2d 1248, 1249 (5th Cir. 1978). Ford Credit's clause meets both parts of the definition.[7]

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[7] Although Ford Credit has not advanced the argument, its *Amici* contend that state law, rather than the Act and 12 C.F.R. §226.2(gg), determines whether a TILA security interest exists. *Amici* Brief at 17-21. *Amici* rely on, but misconstrue, FRB Public Information Letter No. 1263 [1974-1977 Transfer Binder] Cons. Cred. Guide (CCH) ¶31,736 (November 23, 1977). This Letter indicates that state law may be one factor in assessing whether some creditors' interests are TILA security interests. Thus, if state law creates substantive rights that meet the Regulation Z definition of a security interest, such an interest must also be disclosed. The Letter looks to the substantive rights created by state law, the contract or otherwise, not to the label applied by the state law or by the contract. Regulation Z looks to the interest retained and classifies it for disclosure purposes. The court below analyzed Letter 1263 as follows:

> . . . state law can indicate whether a creditor possesses an interest in property securing performance of an obligation; if such an interest is found to exist, federal law defines it as a security interest. A creditor's substantive rights are still governed by state law; federal law merely classifies those rights for disclosure purposes. (J.A. 49) (citations omitted).

Accord: Souife v. *First National Bank of Commerce,* 628 F.2d 480, 483 (5th Cir. 1980); *Hernandez* v. *O'Neal Motors,* 480 F.Supp. 491, 494 (D. N.M. 1979), *rev'd on other grounds,* No. 79-2322 (10th Cir., June 24, 1980). *See also Travis* v. *Trust Co. Bank,* 621 F.2d 148, 150 (5th Cir. 1980); *Elzea* v. *National Bank of Georgia,* 570 F.2d 1248, 1248-50 (5th Cir. 1978); *Edmondson* v. *Allen-Russell Ford, Inc.,* 577 F.2d 291, 293-94 (5th Cir. 1978).

In this case, since Ford Credit's retained interest under the contract meets the Regulation Z definition, and the retention of that in-

Ford Credit's claim on returned insurance premiums is an interest in property. While Ford Credit claims it is an "incidental interest in property" (Brief at 9), it has already claimed a "joint" — i.e., not incidental — interest. If Ford credit is arguing that the property is "incidental," that is not true. The security interest represents a claim on hundreds of dollars, depending on the timing of the cancellation. If an insurance policy with a $400 annual premium is cancelled shortly after payment of the premium, the refund will approach $400. Contrary to Ford Credit's assertion, Ford Brief at 16, n.17, unearned premiums will always be recoverable, except in a small number of cases where the repossession happens to coincide with the end of the term of the insurance. This security is particularly advantageous to creditors in automobile

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terest is not barred by state law, the label applied by state law need not be considered. To the extent state law is pertinent, however, Ford Credit's claim to returned insurance premiums is a security interest under Illinois law. A security interest is "an interest in personal property or fixtures which secures payment or performance of an obligation." Ill. Rev. Stat. ch. 26, §1-201(37). Security interests may be created by "assignment." Ill. Rev. Stat. ch. 26, §9-102(2). The Illinois Commercial Code recognizes that retained interests in insurance are security interests and regulates the perfection and exercise of some, but not all, security interests as defined in §1-201(37). Ill. Rev. Stat. ch. 26, §9-101 *et seq.* It specifically enumerates security interests that are not subject to Article 9 provisions on perfection and exercise. Included in this enumeration is "an interest or claim in or under a policy of insurance, except as provided with respect to proceeds (§9-306) and priorities in proceeds (§9-312)." Ill. Rev. Stat. ch. 26, §§9-306, 312. If retained interests and claims in insurance were not security interests, they would not have been required to be specifically excluded from the technical provisions of Article 9. The only authority cited by *Amici* that retained interests in insurance are not security interests under Ilinois law is an order of the district court in this action that the court withdrew seventeen days later, declaring its prior conclusions "erroneous." (J.A. 19). The Illinois definition of security interest, as set forth in Ill. Rev. Stat. ch. 26, §1-201(37), is the same functional definition as contained in Regulation Z.

credit transactions, since the repossessed vehicle frequently will not generate sufficient proceeds to satisfy the outstanding debt.[8] Returned premiums are an attractive form of secured property in that they may be expeditiously obtained, with virtually no expense to the creditor. The insurance company forwards the premiums on Ford Credit's request. The security interest in them is "a valuable economic right" to Ford Credit. *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291, 294 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). (*See also* section I.D., *infra*).

Ford Credit concedes that its retention of an interest in returned insurance premiums constitutes an interest in property, but characterizes it as "incidental".[9] The characterization of the interest does not control. *Valencia* v. *Anderson Bros. Ford*, (J.A. 49). The first test of a Regulation Z security interest is satisfied by "any interest in property . . ." 12 C.F.R. §226.2(gg).

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[8] The proceeds from the vehicle are insufficient because of the high mark-up on the original sale, rapid depreciation, high finance charges, and the sale of the repossessed automobile at wholesale rather than retail. *See* Federal Trade Commission, Proposed Trade Regulation Rule: Credit Practices, 16 C.F.R. Par. 444, Public Record 215-42, August 1978, at 205-23. Moreover, some creditors manipulate the proceeds of all secured property to assure that no surplus will be realized. In the past Ford Credit arranged to resell repossessed automobiles so that the proceeds from all secured property would be inadequate to meet the debts. *See F.T.C.* v. *Ford Motor Credit Company*, F.T.C. Docket No. 9073 (1978) [1969-1979 Transfer Binder] Trade Reg. Rep. (CCH) 12th Ed. ¶21,536. Ford Credit was required to pay its past customers approximately two million dollars.

[9] "The fact that a particular security interest is small compared to the object of the loan agreement does not change the nature of the interest which the creditor has in the security. The relative size of the security interest given is usually a matter left to negotiation between the parties." *Luczak* v. *General Motors Acceptance Corp.*, 494 F.Supp. 210, 213 n.3 (W.D. N.Y. 1980). Security interests are cumulative and the security interest in insurance premiums is important for its incremental value and ease of enforcement.

> It is not seriously disputed that the assignment of unearned insurance premiums confers on the creditor an interest in property. Even defendants refer to the assignment as an "incidental interest in property." Brief of Appellants at 8. Whether incidental or not, we agree with the Fifth Circuit that such an assignment is an interest in property. *Valencia* v. *Anderson Brothers Ford* (J.A. 49).

The second component of the Regulation Z definition of a security interest is stated in the disjunctive: "any interest in property *which secures payment or performance of an obligation.*" 12 C.F.R. §226.2(gg) (emphasis supplied). Ford Credit's claim on returned insurance premiums secures both payment *and* performance of an obligation.

Paragraph 17 of the contract expressly authorizes Ford Credit to apply refunded insurance premiums toward "payment of the indebtedness." The clause thus provides security for the payment of the consumer's credit obligation. This "places the assignment squarely within the definition of security interest under Regulation Z." *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556, 559 (8th Cir. 1980).[10] Furthermore, under Ford Credit's view, the purpose of the premium refund clause "is to assure the continued existence of the insurance on the vehicle during the life of the loan." Ford Brief at 4. Ford Credit thus admits that its interest in returned premiums also

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[10] The overwhelming weight of case law is in accord. *See Valencia* v. *Anderson Bros. Ford*, 617 F.2d 1278 (7th Cir. 1980); *Souife* v. *First National Bank of Commerce*, 628 F.2d 480 (5th Cir. 1980); *Edmondson* v. *Allen-Russell Ford, Inc. and Ford Motor Credit Co.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951 (1979); *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F. 2d 437 (3rd Cir. 1977); *Luczak* v. *General Motors Acceptance Corp.*, 494 F.Supp. 210 (W.D. N.Y. 1980); *Ferguson* v. *Centran Bank of Akron*, CCH Cons. Cred. Guide ¶97,292 (D. Ohio 1980); and *Hagler* v. *Ford Motor Credit Co.*, 381 So.2d 80 (Ala. App. 1980). Ford Credit cites five contrary cases. Brief at 24, n.9. Two of these cases, however, *Mullen* v. *North Pacific Bank*, 610 P.2d 949 (Wash. App. 1980), and *Ector* v. *Southern Discount Co.*, No. C78-899A (N.D. Ga. 1980) (Ford Add. 11-17), do not concern returned insurance premiums. A third, *Rounds* v. *Community National Bank*, 454 F.Supp. 883 (S.D. Ill. 1978), was reversed in effect by the decision below in this case.

secures performance of the buyer's contractual obligation to maintain insurance coverage, thereby satisfying the alternative requirement in the second prong of the Regulation Z definition of "security interest". *Valencia* v. *Anderson Bros. Ford,* (J.A. 49 n.10); *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291, 294 (5th Cir. 1978), *cert. denied,* 441 U.S. 951 (1979).

In an attempt to evade the clear embrace of the Regulation Z definition, Ford Credit argues that 12 C.F.R. §226.2(gg) does not "expressly cover" the interest in returned premiums and focuses on the list of examples set out in the definition. Ford Credit asserts that the examples represent security interests of a different nature than its interest in returned premiums, and asserts the principle of *ejusdem generis.*

Ejusdem generis is inapplicable where the context manifests a contrary intent. *Gooch* v. *United States,* 297 U.S. 124, 128 (1936). While Ford Credit has tracked the list of examples in 12 C.F.R. §226.2(gg) (Brief at 8), it has omitted the crucial phrase which precedes the list: "[t]he terms include, but are not limited to. . . ." Where there is an introductory clause such as "including, but not limited to . . .," *ejusdem generis* does not apply because such language is used to avoid the application of the rule. *Ramirez Leal & Co.* v. *City Demonstration Agency,* 549 F.2d 97, 104 (9th Cir. 1976), *pet. for rehearing denied,* 549 F.2d 156 (9th Cir. 1977); *Eastern Air Lines, Inc.* v. *McDonnell Douglas Corp.*, 532 F.2d 957, 988-89 (5th Cir. 1976). *See also Harrison* v. *PPG Industries, Inc.* 446 U.S. 578, 588-589 (1980).[11]

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[11] Ford Credit's conclusion that the examples in the definition are different in kind from the security interest in returned premiums is unsupported by any analysis or authority, and is incorrect. The list includes "consensual . . . liens whether or not recorded . . .," 12 C.F.R. §226.2(gg), an example parallel to the interest in controversy. As a result, even if *ejusdem generis* were applied, it would not exclude returned premiums from the broad definition of security interest. *See Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 588-89 (1980).

The Board recognized the all-inclusive nature of the Act's requirement that "any" security interest held must be disclosed when it broadly defined "security interest" in the regulation. The Act and Regulation Z thus require disclosure of Ford Credit's security interest in returned insurance premiums.

C. SINCE 1970 FRB PUBLIC INFORMATION LETTER NO. 377 HAS REQUIRED THE DISCLOSURE OF A CREDITOR'S CLAIM ON REFUNDED INSURANCE PREMIUMS AS A *TILA* SECURITY INTEREST; A RECENT BOARD STATEMENT ASSUMES THE SAME REQUIREMENT

One year after the effective date of TILA, the Board issued a Public Information Letter which required disclosure of a creditor's retention of an interest in returned insurance premiums as a TILA security interest. FRB Public Information Letter No. 377, [1969-1977 Transfer Binder] Cons. Cred. Guide (CCH), ¶30,555 (July 22, 1970).[12] The interpretation relied on three key factors dictating disclosure, all of which are present in this case. First, both involve a creditor gaining an exclusive interest in returned insurance premiums which

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[12] The FRB responded to creditor's counsel as follows: "As we understand the proposed plan, your client proposes to place literature in its loan offices concerning insurance to be sold by a company unrelated to your client. Applications for a single premium lifetime accidental death and dismemberment policy are available in each [loan] office and if a customer desires to purchase such a policy with the proceeds of his loan, a check will be sent directly to the company from your client [the loan company] in payment of the premium. While your client will not require the purchase of this insurance and the proceeds of the policy would in no circumstances be used to pay any portion of the unpaid balance of the loan, your client would be designated as owner of the policy during the term of the loan. *In the event of the customer's default, your client would have the right to cancel the policy and apply any premium refund to the unpaid balance of the loan.* Under the circumstances, *we think it would be appropriate to disclose the loan company's ownership of the policy as a type of 'security interest' under [12 C.F.R.] Section 226.8(b)(5) . . ..*" (emphasis added).

would otherwise be payable to the consumer. Second, the creditor in both situations is empowered to cancel the insurance upon default. Third, the creditor is specifically authorized to apply all refunded premiums to the unpaid balance of the credit obligation, thus discharging in full or in part the debt and providing additional security to the creditor.[13] This Public Information Letter is entitled to substantial deference. *Philbeck* v. *Timmers Chevrolet, Inc.*, 499 F.2d 971, 977 (5th Cir. 1974).

The FRB's consistent understanding that security interests in insurance proceeds must be disclosed under the Act and Regulation Z is further evident in a recent statement regarding proposed new Regulations to implement the TILA

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[13] Ford Credit's *Amici* try unsuccessfully to distinguish this interpretation. (Brief at 18). First, the *Amici* argue that the Letter concerns a set of facts where "a credit transaction [is] undertaken for the express purpose of acquiring insurance." The Letter, however, does not support this statement; it merely indicates that insurance would be purchased "with the proceeds" of the loan, but does not suggest the purpose of the loan or that the entire proceeds of the loan would be so expended. In any event such as transaction is substantially similar to those instances where the property damage insurance is included in and financed by the same contract used for the purchase of the automobile. This arrangement is so common in automobile financing that the Ford Credit form contract has specific provisions and charge itemization blanks for the financing of the insurance. (J.A. at 67). *Amici* also claim that the Letter states that the insurance premiums would be "the only collateral" in the credit transaction. The Letter contains no such statement. The final distinction urged by the *Amici* is that the creditor in the Letter gained an interest in the premiums via a contractual designation as "owner of the policy." While this distinction is at least accurate, it is without substance. It is not the creditor's appellation which controls the question of whether a security interest has been created; it is the bundle of rights which must be examined instead. *See Gilbert* v. *Wood Acceptance Co.*, 486 F.2d 627, 632 (7th Cir. 1973); and *Lewis* v. *Walker Thomas Furniture Co., Inc.*, 416 F.Supp. 514, 516 (D. D.C. 1976) ("creditors must not be allowed to decide for themselves what language is sufficient to satisfy the requirements of the law.").

Simplification and Reform Act, effective in 1982 (hereafter "Simplification Act"), Pub.L. 96-221, Title VI, 94 Stat. 168. In proposing the new Regulation Z, the FRB inquired of the public: "Should a *security interest be defined more narrowly than under the current regulation, to exclude* a number of incidental property interests, such as accessions, accessories and *interests in insurance and unearned insurance proceeds?*" Federal Reserve Board Press Release, Nov. 28, 1980, (Add. 1) (emphasis supplied). This statement concerning the current regulation comports with the regulation's plain meaning.

D. THE DISCLOSURE OF A SECURITY INTEREST IN REQUIRED INSURANCE IS SIGNIFICANT AND MEANINGFUL TO CONSUMERS, THEREBY PROMOTING THE PURPOSES OF *TILA*

1. The main thrust of Ford Credit's argument is that even though the retained interest in required insurance is a security interest, it need not be disclosed because it "is of virtually no consequence to the debtor," and its disclosure would not be understood by consumers or used for comparison shopping. Ford Brief, at 18.[14] However, "[i]f the security interest was important enough for [Ford Credit] to acquire, it was important enough to disclose." *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291, 294 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979).

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[14] Since the statue and regulation require disclosure, Ford Credit is inappropriately second-guessing the judgment of Congress and the FRB. Ford Credit's argument is that the declaration of purpose provision of the statue controls the provision regarding disclosure of "any security interest." A preamble does not control the plain language of provisions in the body of the statue when it would lead to a construction inconsistent with the plain language. *Price* v. *Forest*, 173 U.S. 410, 427 (1899). All parts of an act, if possible, are to be given effect. *F.A.A. Administrator* v. *Robertson*, 422 U.S. 255, 261 (1975). Moreover, as demonstrated in the text, disclosure of the security interest at issue fulfills the purposes in the preamble of uniform disclosure and "avoid[ing] the uninformed use of credit." 15 U.S.C. §1601(a).

The security interest in required insurance is substantial from the consumer's point of view.[15] In the case at bar the annual premium was $215. In *Hernandez* v. *O'Neal Motors, Inc.*, No. 79-2322 (10th Cir., June 24, 1980), *petition for cert. filed sub nom. James* v. *Ford Motor Credit Co.*, ____ U.S. ____, the physical damage insurance premium in one of the consolidated cases was $288.40 for six months and Ford Credit financed the automobile over a four year period. *Hernandez*, Record on Appeal, vol. viii at 247.

Physical damage insurance is not sold for terms of more than one year. It is common for automobiles to be financed over periods of three or four years. Because the insurance must be periodically repurchased, the value of this security interest is replenished with each subsequent repurchase. In the *Hernandez* case, for example, the security interest in insurance premiums is as valuable to Ford Credit in the 43rd month of the contract as it was during the first month; in contrast, the value of the automobile as a security interest constantly declines.

A properly disclosed security interest in returned insurance premiums would be understood by consumers and used for comparison shopping. The concept of a security interest is understood by consumers to allow the creditor, without notice, to take the debtor's money or property. Automobile purchasers know the creditor can take back the car if pay-

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[15] Congressional history belies Ford Credit's claim that the interest in returned insurance premiums is insignificant and was of no concern to Congress. In the year preceding passage of TILA there were extensive hearings concerning abuses and hidden profits in the consumer credit insurance industry. *Hearings before the Subcommittee on Antitrust and Monopoly, Senate Judiciary Committee*, 90th Cong. 1st Sess. (1967). Some 3500 pages of testimony and exhibits were presented at these proceedings. Undisclosed retention of returned insurance premiums and resulting abuses were explicitly addressed by witnesses in the 3500 pages of the hearings. *See, e.g., id.* at 27. Statement of James H. Hunt, Vermont Commissioner of Banking and Insurance.

ments are not made. Consumers who obtain loans at a finance company know the security interest in household goods means the creditor can take those goods if there is a default in payments. Similarly, consumers understand the effect of a security interest in other property such as insurance premiums when that fact is disclosed. In addition unless the creditor's security interest in insurance is meaningfully disclosed consumers will not recognize those instances where the refunded premiums are not properly credited to the outstanding balance at default. This result also is plainly inconsistent with the Act's goal of helping consumers "avoid the uninformed use of credit." 15 U.S.C. §1601.

2. Prior to the enactment of TILA, each creditor disclosed as much or as little as it deemed useful to itself, in the terminology of its choice. Understanding the provisions, comparison credit shopping and the informed use of credit were difficult, if not impossible tasks.

TILA was meant to effect a major change in credit practices. Credit information is required to be set forth in clear and conspicuous fashion. It mandates uniform terminology and disclosure in meaningful sequence on the front side of the contract or disclosure sheet. 12 C.F.R. §§226.6(a) and 226.8(a). It standardizes credit disclosures, thereby improving the ability of a consumer to make intelligent choices.[16] There has been an increasing understanding among consumers of the meaning of terms standardized by TILA.[17] *See* Annual Report To

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[16] TILA standardized disclosure through the use of uniform terms and technical methods of computing credit rates. Ford Credit argues that this security interest does not have to be disclosed because it is "technical." Labelling the disclosure in this case as technical does not advance Ford Credit's argument; the entire TILA has been described by this Court as "highly technical." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980).

[17] Calling its security interest in returned premiums an "assignment" is an "attempt to characterize . . . [the] transactions so as to fall one step outside whatever boundary Congress attempted to establish . . . [in TILA]." *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 365 (1973).

Congress On Truth in Lending For The Year 1977, Board of Governors, CCH Cons. Credit Guide Issue No. 484 Part II, January 10, 1978.

Ford Credit's retention of a security interest in returned insurance premiums uses convoluted "assignment" language on the reverse side of the contract. It is an anachronism exemplifying the problems Congress set out to address in 1968.

Creditors who have routinely disclosed their security interest in returned insurance premiums have done so in a concise yet informative manner. In *Bulger* v. *Thorpe Credit, Inc.*, 609 F.2d 1255, 1257 (7th Cir. 1979), the creditor merely appended the words "and all unearned credit insurance premiums" to its security interest disclosure. The Third Circuit noted that the "insurance security interest could have been identified clearly by a phrase such as 'this loan is secured by any insurance required or purchased' . . ." *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437, 442 n.17 (3rd Cir. 1977). *See also Luczak* v. *General Motors Acceptance Corporation*, 494 F.Supp. 210, 214 (W.D. N.Y. 1980). Moreover, in response to the numerous decisions on this issue, Ford Credit has altered its contract to disclose the security interest on the face of the contract by inserting a mere five words:

> Security Interest: The Buyer gives the Creditor a security interest . . . in the vehicle . . . *and in all insurance charges* . . .

Ford Credit Illinois Automobile Retail Installment Contract, ¶11, (Add. 2) (emphasis supplied). In so doing the "assignment" clause was dropped from the reverse side and the overall length of the contract was actually decreased. Ford Credit's "information overload" argument is thus specious. Rather than frustrating the purpose of TILA, the disclosure has resulted in a shorter credit contract which explains clearly to consumers that the creditor is reserving a security interest in insurance premiums.

By burying its security interest in refunded premiums on the former contract's reverse side in a mist of legalese, Ford Credit made it nearly impossible for consumers to be aware of this security interest. This misled consumers who properly relied on the disclosures on the front and the minimized significance, under TILA, of the reverse side of the contract. *See Luczak* 484 F.Supp. at 214.

3. In *Mourning* v. *Family Publications Service,* 411 U.S. 356, 377 (1973), this Court described the guiding rationale of TILA:

> The Truth in Lending Act reflects a transition in congressional policy from a philosophy of let the buyer beware to one of let the seller disclose. By erecting a barrier between the seller and the prospective purchaser in the form of hard facts, Congress expressly sought 'to . . . avoid the uninformed use of credit.' [citations omitted].[18]

The recent holding in *Ford Motor Credit Co.* v. *Milhollin,* 444 U.S. 555 (1980), also supports requiring disclosure of a creditor's security interest in premium refunds. The TILA goal of meaningful disclosure is "a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . [information overload].' " *Id.* at 568. The creditor in *Milhollin* had used a form which properly disclosed prepayment rebate practices, but did not disclose acceleration rebate practices. The Court held that acceleration rebate practices were not required to be disclosed unless they diverged from the already disclosed prepayment rebate practices. The Court adopted the reasoning of the Federal Reserve Board that the two rebates were not so analytically distinct as to require inde-

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[18] Ford Credit's suggestion (Brief 30-31) that the damage provisions of the Act merit strict construction in favor of the creditor contradicts this Court's ruling in *Mourning* v. *Family Publications Service, Inc.,* 411 U.S. at 375-76. In light of its underlying remedial purposes, the Act is to be given a liberal construction to effectuate its goal of consumer protection. *Mirabal* v. *General Motors Acceptance Corp.,* 537 F.2d 871, 878 n.12 (7th Cir. 1976), and cases cited therein.

pendent disclosure. Where acceleration practices mirrored disclosed prepayment procedures, requiring a duplicative disclosure would cause "information overload." *Id.* at 562.

In the instant case however, the disclosure of Ford Credit's security interest in premium refunds would not duplicate any other credit disclosures. Instead, it would be the only disclosure advising the consumer that his insurance premium refunds were security for the creditor. Requiring the disclosure "rationally accommodates the conflicting demands for completeness and simplicity." *Ford Motor Credit Company* v. *Milhollin,* 444 U.S. at 569. As suggested by the courts and belatedly adopted by Ford Credit (*see* p. 21, *supra*), the straightforward disclosure of the security interest in insurance is shorter, clearer and more meaningful to consumers than the long, vague, legalistic and hidden assignment provision in question.

II. Ford Credit's Reliance on Statutory Amendments Intended to Apply to Future Transactions is Misplaced

In 1980, Congress enacted substantial amendments to the TILA, Pub.L. No. 96-221, Title VI, 94 Stat. 168 (1980). The law, commonly known as the Truth in Lending Simplification Act, was signed on March 31, 1980. No provision of the Act had retroactive application. One provision, Pub.L. No. 96-221, §608, not relevant to this case, took effect immediately. The remainder of the Simplification Act is not effective until April 1, 1982, except that the Federal Reserve Board must issue regulations by April 1, 1981, and creditors have the option of complying with such regulations upon adoption. Pub.L. No. 96-221, §625.[19]

Ford Credit argues that this case should be decided in accordance with the Simplification Act, which has not yet taken

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[19] As of this date, the Board's second draft of the omnibus implementing regulations has been published for public comment, 45 Fed.Reg. 80648 (December 5, 1980), but the final regulations have not been adopted.

effect, rather than under the law in effect when the contract was signed. This argument is without merit. It has been analyzed and rejected in *Murphy* v. *Ford Motor Credit,* 629 F.2d 556, 560 (8th Cir. 1980), *Souife* v. *First National Bank,* 628 F.2d 480, 484 (5th Cir. 1980), and *Luczak* v. *General Motors Acceptance Corp.,* 494 F.Supp. 210, 213, n.2 (W.D. N.Y. 1980).

A. CONGRESS INTENDED THE SIMPLIFICATION ACT TO HAVE ONLY PROSPECTIVE APPLICATION.

Congress could have, but did not make the Simplification Act retroactive in effect. In 1974, Congress amended the TILA to limit creditor liability in class actions, and to provide a defense from liability for compliance with a regulation or interpretation of the Board. These and other amendments were specifically made applicable to pending litigation which had not reached final judgment. *See* 15 U.S.C. §1640, Pub.L. No. 93-495, §408(e)(1974).[20] Congress' failure to include a similar provision in the Simplification Act establishes that the Act does not apply to prior consumer transactions and to litigation concerning such contracts. In addition, since the Simplification Act does not extinguish liability for TILA violations occurring prior to its effective date, by virtue of 1 U.S.C. §109 Ford Credit's liability is not altered by the enactment of the amendments.[21] *See DeLaRama S.S. Co.* v. *United States,* 344 U.S. 386 (1953).

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[20] A second group of 1974 amendments were effective immediately upon enactment, and a third group were not effective until one year after enactment. Congress is thus well aware that in amending the TILA it can make amendments effective at different times.

[21] 1 U.S.C. §109 provides that an amendment or repeal of a prior statute:

> shall not have the effect to release or extinguish any penalty, forfeiture, or liability incurred under such statute, unless the repealing Act shall so expressly provide, and such statute shall be treated as still remaining in force for the purpose of sustaining any proper action or prosecution for the enforcement of such penalty, forfeiture, or liability.

B. THE SIMPLIFICATION ACT CHANGES THE PRIOR LAW AND THUS DOES NOT INTERPRET THE INTENT OF CONGRESS IN ADOPTING THE *TILA* IN 1968.

Among the prospective changes made by the Simplification Act is a change in the requirements regarding disclosures of security interests. Instead of requiring a disclosure of "any security interest held or retained," 15 U.S.C. §1638(a)(10), the amendment will require disclosure of "a security interest" in

> (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type. Pub.L. No. 96-221, §614.[22]

When Congress changes a statute prospectively, there is no basis to assume, as Ford Credit does, that the requirements and intent of the prior law or the judicial applications thereof are intended to be altered for events occurring during the time the prior law was in effect. Thus, in *United States* v. *Plesha,* 352 U.S. 202, 208 (1957) this Court rejected the argument that the history of the 1942 amendments to a law was proper to use in construing the 1940 law: "if the legislative history . . . indicates anything, it is that Congress thought that it was changing the law by changing the language of the Act." *See also Souife* v. *First National Bank of Commerce,* 628 F.2d at 484-85. In this case Congress has simply altered the law prospectively. There is nothing in the statute or committee reports that purports to interpret the existing TILA.

The committee reports do express concern about the economic and policy results of the prior statute. Virtually all legislative changes are predicated on a claim of deficiencies in the statute being amended. But Congress knows well how to

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[22] This case does not present the issue of whether under the Simplification Act and its legislative history, the security interest in unearned physical damage insurance premiums will have to be disclosed. *See Souife* v. *First National Bank of Commerce,* 628 F.2d 480-484-85 (5th Cir. 1980). Ford Credit's assumption that there will be no disclosure requirement is, however, premature.

amend a law retroactively or how to state its belief that the courts have misinterpreted a statute. In this instance the committee reports notably fail to do either. The portion of the Senate Report that Ford Credit cites (Ford Brief at 19) is immediately preceded by the statement that "the act could be substantially improved." S.Rep. No. 73, 96th Cong., 1st Sess. 2 (1979), *reprinted in* [1980] U.S. Code Cong. & Ad. News 878-79 (May, 1980 Supp.). Not a single word, phrase or sentence in the lengthy excerpts of the committee report quoted by Ford Credit (Ford Brief at 19-20) and in *James* v. *Ford Motor Credit Company,* No. 78-1806 (10th Cir. 1980) suggest an intent to construe the prior act.[23] Rather, the reports are permeated by an intent to change the statute, not reconstrue the original provisions. This is true of the security interest provisions as well, which is "*simplified* to *eliminate* the technical disclosure . . . [T]he Committee *intends this* [new] *provision* to require a listing [of only certain security interests]." S.Rep. No. 96-368, 96th Cong. 1st Sess. 30 (1979), *reprinted in* [1980] U.S. Code Cong. & Ad. News 834, 864 (May, 1980 Supp.) (emphasis added).

C. A STATEMENT BY SENATOR GARN IN 1980 DOES NOT REFLECT THE INTENT OF THE CONGRESS WHICH PASSED THE *TILA* IN 1968, WHEN SENATOR GARN WAS NOT IN CONGRESS.

There is one snippet of legislative history belatedly and incorrectly suggesting that the TILA phrase "any security interest" means something other than what the words mean, and that the 1980 Simplification Act amendment reflects Congress' intent in the 1968 Act. It is contained in a statement in-

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[23] Ford Credit (Ford Brief at 19) emphasizes that the court decisions on various TILA issues (not specifically the security interest cases) were described in the report as "highly technical." S.Rep. No. 73, 96th Cong., 1st Sess. 2 (1979), *supra.* The Act is, of course, "highly technical." *Ford Motor Credit Co.* v. *Milhollin,* 444 U.S. 555, 566 (1980). "Highly technical" decisions are not incorrect decisions, and the committee, addressing the cases directly, chose not to describe such decisions as incorrect interpretations of the TILA.

serted in the Congressional Record by Senator Garn during the debate on the Simplification Act. 125 Cong.Rec.S. 4990 (daily ed. May 1, 1979). Senator Garn's position thus contradicts the authoritative committee reports on the purpose of the Simplification Act.[24] Moreover, Senator Garn was not a member of Congress at the time the TILA was drafted and enacted in 1968.

This court has consistently held that the post-passage pronouncements of individual legislators, purporting to describe the meaning or intent of a previously enacted statute, have little if any weight in the judicial construction of the statute. *United States* v. *United Mineworkers of America,* 330 U.S. 258, 281-82 (1947) (noting also that some of the senators expressing opinions were not members of the Senate when the law was passed); *Consumer Product Safety Commission v. GTE Sylvania, Inc.,* ___ U.S. ___, 64 L.Ed.2d 766, 768 (1980); *Quern* v. *Mandley,* 436 U.S. 725, 736 n.10 (1978) (discounting post-passage observations by a single member of Congress); *International Brotherhood of Teamsters* v. *United States,* 431 U.S. 324, 354 n.39 (1977); *Regional Rail Reorganization Act Cases,* 419 U.S. 102, 132 (1974) (rejecting post-passage views of 36 Congressmen); *National Wood-Work Manufacturers Association* v. *National Labor Relations Board,* 386 U.S. 612, 639 n.33 (1967) (discounting "the personal views of these legislators"); *United States* v. *Wise,* 370 U.S. 405 (1962).[25]

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[24] In addition to the reasons discussed in the text, *infra,* for rejecting the post-passage remark of a single legislator as a basis for construing a statute, additional cautions should operate here. Senator Garn was a member of the committee which did not present his view in its report. The logical conclusion is that either he expressed his position in committee and the committee rejected it, or he did not formulate his opinion until after the committee report was issued. Moreover, because Senator Garn's statement was written and inserted in the Congressional Record, rather than being made in an actual floor debate, it was not subject to normal discussion, much less to possible queries as to its inconsistency with the committee report.

[25] Ford Credit (Brief at 22) relies on a line of cases in which the Court used customary sources of construction, *i.e.,* language of the

Ford's contention that the Simplification Act interprets the TILA thus is based solely on the post-passage statement of a single senator who was not a member of Congress at the time TILA was enacted, and whose belated statement explains the purpose of the 1980 amendment in a manner at variance with the purpose enunciated by the committee. This can hardly support a finding that the Simplification Act interpreted the TILA or its security interest provisions.

III. An Unadopted Federal Reserve Board Interpretation Is Entitled to No Deference, Weight or Consideration by This Court

In September 1980, the Federal Reserve Board released Proposed Official Staff Interpretation FC-0173, 45 Fed.Reg.

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statute, committee reports, and agency interpretations, to construe prior legislation. None of these cases used a single remark by a single legislator. In *Red Lion* v. *Federal Communications Comission,* 395 U.S. 367, 381 (1969), a challenge to the FCC fairness doctrine was rejected because statutory amendments facially "ratified" a longstanding FCC interpretation of the prior act. In *National Labor Relations Board* v. *Bell Aerospace Company Division of Textron, Inc.,* 416 U.S. 267 (1974), the subsequent legislation re-enacted a statute with no pertinent change, in conjunction with a longstanding NLRB interpretation. *Id.* at 274, 276. Similarly, in *Seatrain Shipbuilding Corp.* v. *Shell Oil Company,* 444 U.S. 572 (1980) the agency had consistently interpreted the Act, and a committee report explaining a subsequent amendment to another provision of the Act stated specifically it did not mean to affect the prior provision and its interpretation. The subsequent history referred to in *Regents of University of California* v. *Bakke,* 438 U.S. 265, 349 (1978) (Justices Brennan, White, Marshall and Blackmun) involved the effect of a subsequent statute other than the one being construed, not a floor statement, and the later statute presented a problem of irreconcilability. Moreover, even when substantial subsequent legislative history specifically purports to construe prior legislative intent, this Court evaluates the weight to be given such statements with the "oft repeated warning that views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *Consumer Product Safety Commission, et al.* v. *GTE Sylvania, Inc., et al.,* ___ U.S. ___, 64 L.Ed.2d 766, 778 (1980).

63295 (Sept. 24, 1980) (Ford Brief at Add. 55), asking for comments on whether disclosure of security interests in returned premiums should not be required. The notice explicitly stated that, after comments, the proposed interpretation might be amended or withdrawn:

> (2) The letter is being issued as a proposal, rather than in final form, and interested persons are invited to submit relevant comments.
>
> (3) After comments are considered, this official staff interpretation may be amended, may be withdrawn or may remain unchanged.

Furthermore, the Board explicitly advised creditors in a mailing of November 24, 1980, that "This proposed interpretation may not be relied upon until final action is taken." Add. 3. Final action has never been taken, and on December 16, 1980, the Board deferred further consideration indefinitely. 45 Fed.Reg. 84074 (December 22, 1980), Ford Brief, Add. 58.

Ford Credit argues that this *proposal* represents the Board's position and is entitled to great weight. (Ford Brief at 18, 32-34, 40). Ford Credit has cited no authority and no logical basis for relying on unadopted agency proposals.

The Board properly noted that since the opinion was only proposed, it did not constitute legal authority. Ford Credit rejects the real opinion in the Board proposal — that its unadopted interpretation has no meaning. The Board is correct. If proposals are treated as anything more than what they are — lightning rods for public comment — the entire process of proposing rules and regulations for comment would be subverted. In many circumstances agencies would be reluctant to propose rules for comment; in others mere proposals would be pushed through in order to affect conduct or litigation without running the risks of actually adopting a rule after

public comment or scrutiny.[26] Alternatively, agencies would be required to frame proposals only as questions, foregoing the valuable comments adduced by specific proposed language and the implications or ambiguities identifiable in such language.

Thus, the Board itself has prohibited creditor reliance on the proposed interpretation. Despite the fact that no judgment has been made, Ford Credit relies extensively on what it heedlessly asserts is the "informed judgment of the Board and its staff." Ford Brief at 30.

The procedure followed in proposing FC-0173 was unusual for the Board, thereby further demonstrating the tentative nature of the proposed interpretation and the desire to hear arguments from creditors and consumers before taking final action. Official interpretations are initiated by a request from a creditor for an official interpretation of a specific section. Normally, the Board will respond to the request by issuing an official interpretation; members of the public may then request the opportunity for comment. *Ford Motor Credit Co.* v. *Milhollin,* 444 U.S. 555, 567, n.10 (1980). If the Board decides not to allow public comment, the interpretation stands without further action. If the Board decides to allow public comment, the interpretation is withdrawn and the period for comment announced.

A different procedure was followed with regard to FC-0173. The Board never issued an official interpretation. The only notice was a proposed official interpretation with an immediate request for public comment. The Board was thus not making a judgment; instead it requested additional views of interested parties in order to allow it, at a later date, to make an

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[26] In the David-and-Goliath context often inherent in the regulatory process, it is not uncommon that an interest group or corporation obtains at least a proposed rule, but the public comments act as a brake on administrative agency action. *Cf.* M. Asimow, "Public Participation in the Adopting of Interpretive Rules and Policy Statements," 75 Mich.L.Rev. 521-84 (1977); C. Koch, "Public Procedures for the Promulgation of Interpretive Rules and General Statements of Policy," 64 Geo.L.J. 1047-79 (1976).

informed judgment. Contrary to Ford Credit's argument, there is no statement or inference in *Milhollin* that *proposed* interpretations are entitled to any weight, particularly when the Board had prohibited creditor reliance and deviated from its normal procedure of simply issuing interpretations.

Even if proposed interpretation FC-0173 had been issued in final form, it would still be entitled to little or no deference under *Milhollin*. The question in *Milhollin* was whether the TILA required disclosure of an acceleration clause. The Court found that "the issue of acceleration disclosure is not governed by clear expression in the statute or regulation," and therefore deferred to the several consistent interpretations of the FRB. *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 560 (1980). The case at bar presents a very different situation. Since the Act and Regulation Z expressly require disclosure of the security interest at issue (see section I.A., *supra*), it is unnecessary for this Court to look to the proposed interpretive rule. *See Milhollin, supra*, 444 U.S. at 560.

If proposed interpretation FC-0173 has been adopted, moreover, it would not control this case. The proposal does not conclude that the interest retained in insurance premiums is not a security interest — the determinative issue under TILA. Rather, it applies a test of "incidentalness," a criterion which directly contravenes the TILA statutory requirement that "any security interest" be disclosed, 15 U.S.C. §1638(a)(10). The proposal is not longstanding, not consistent with other FRB pronouncements, and not rational (see section I., *supra*). It therefore would not control. *See Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980); *Skidmore* v. *Swift and Co.*, 323 U.S. 134 (1944); *Morton* v. *Ruiz*, 415 U.S. 199 (1974); *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 n.20 (1979); *General Electric* v. *Gilbert*, 429 U.S. 125, 141-143 (1976).[27]

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[27] Ford Credit's reliance on FC-0173 assumes a reading of *dictum* in *Milhollin* v. *Ford Motor Credit, supra*, under which traditional notions of the level of deference applied to legislative rulemaking pursuant to an explicit legislative delegation would be extended to

It would be illogical to give any weight to a proposed interpretation, as by its nature the proposal is subject to change. Proposed Interpretation FC-0173 is unadopted, and contradicts the express language of the Act, Regulation Z, and other FRB pronouncements.[28] As a consequence it should not affect this Court's resolution of this case.

IV. There Is No Case or Controversy as to Ford Credit's Request That This Court Not Apply Its Decision "Retroactively" to Litigants Other Than the Respondents in This Case

For Credit argues that a ruling for the respondents should "be given only prospective application *except as to the Buyers.*"

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the context of administrative interpretations of particular statutory language. *But see K. Davis, Administrative Law Treatise,* Vol. 2, §7:8 at 36-42 (2d ed. 1979), and *Skidmore* v. *Swift & Co.,* 323 U.S. 134 (1944). This Court need not, of course, assess the correctness of Ford Credit's reading of *Milhollin* since FC-0173 was never adopted.

[28] In addition, proposed FC-0173 "recognizes that there are a number of Circuit Court decisions to the contrary." Interpretations that are primarily litigation-inspired are not entitled to great deference. *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.,* ___ U.S. ___, 64 L.Ed.2d 766 (1980). Moreover, by its proposed interpretation, the Board has interpreted *Milhollin* to give it the authority to act as an ultimate court of review with power to reverse decision of the Circuit Courts of Appeal and even this Court. The Board's "*deferral* of final action" on December 15, 1980, "in light of the Supreme Court's grant of certiorari" in this case suggests that when this court affirms, the Board may be assuming the right to nullify the decision. Such an interpretation and use of *Milhollin* will increase and extend the time of litigation under TILA. Creditors may litigate any issue throughout the court system and if they win the issue is over. However, if the creditors lose, they may then take the issue to the Federal Reserve Board to reverse a court's decision, thus giving the creditors a second bite at the apple. In practice, the FRB opinions and interpretations are issued only at the request of creditors and not at the request of consumers. If a consumer believes that the Act has been violated, he will bring an action in court. This is the method established by Congress for consumer enforcement of the TILA. FRB interpretations and opinions, on the other hand, are used to protect creditors from liability.

Ford Brief at 35, 44 (emphasis supplied).[29] As Ford Credit presents the issue, it fails to present a case of controversy as required by Article III of the Constitution. Ford Credit's express concession that the respondents should recover damages regardless of a prospective application of the decision destroys any adversarial relationship on this issue.

The case or controversy requirement limits courts to "adjudication of actual disputes between adverse parties." *Richardson* v. *Ramirez*, 418 U.S. 24, 36 (1974).

> [F]ederal courts are without power to decide questions that cannot affect the rights of litigants in the case before them . . . *North Carolina* v. *Rice*, 404 U.S. 244, 246 (1971).

In certain unusual circumstances, this Court may give a ruling prospective application only. "Non-retroactivity" may bar application of a decision to all litigants, or to all except the one in the case being decided. In either situation, since the litigant in the case has an interest in asserting that he should benefit from the ruling, there is a case or controversy.[30] *See Linkletter*

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[29] Ford Credit took the same position in the Court of Appeals. J.A. 54. We would also note that Ford Credit incorrectly uses the term "prospective" to preclude liability on cases already filed or to be filed within the statute of limitations; such cases are, however, precisely those which this Court has frequently considered not barred by a prospective-only application. *See Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969): "[W]e will apply our decision in this case prospectively. That is, we will apply it only where, under state law, the time for challenging the election result has not expired, or in cases brought within the time specified by state law for challenging the election and which are not yet final." *See also Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371 (1939). For purposes of this argument, however, respondents will use the terms in the manner Ford Credit does.

[30] Thus if Ford Credit had taken issue with the application of an affirmance to respondents, the Court would have had a live case or controversy, one possible resolution of which would have been to apply the decision "retroactively" to the respondents but not to others.

v. Walker, 381 U.S. 618, 622 n.3 (1965). *But see Stovall* v. *Denno,* 388 U.S. 293, 301 (1967).

In this case, as to the "non-retroactivity" issue, Ford Credit has asked the court for no relief that affects the respondents in any manner and for no alteration in the Judgment. There is therefore no adversarial relationship on this issue and no case or controversy.

In *Relford* v. *United States Disciplinary Commandant,* 401 U.S. 355, 369-70 (1971), this Court refused to reach the issue of retroactivity of a prior decision because, given the disposition of *Relford,* there was no controversy as to retroactivity and that issue would be "better resolved in other litigation." The Court cited *Alabama State Federation of Labor* v. *McAdory,* 325 U.S. 450, 461 (1945), which refused to decide an issue where there was no case or controversy, and dismissed the writ of certiorari.

In not contesting the respondents' recovery, Ford Credit has eliminated the crucial element of adverse interest. The request for prospective application — in the posture presented to this Court — is nothing more than a request for an advisory opinion:

> [S]uch suits often 'are not pressed before the Court with that clear concreteness provided when a question emerges precisely framed and necessary for decision from a clash of adversary argument exploring every aspect of a multifaced situation embracing conflicting and demanding interests.' *Flast* v. *Cohen,* 392 U.S. 83, 96-97 (1968) (citation omitted).

Ford Credit desires an advisory opinion limiting its potential exposure in other actions. Respondents here are not parties in any of the other lawsuits to which Ford Credit refers. Other pending litigation cannot create a case or controversy where it is absent in the case at bar. *Local No. 8-6* v. *Missouri,* 361 U.S. 363, 370 (1960); *American Book Co.* v. *Kansas,* 193 U.S. 49, 52 (1904). Justiciability is determined not by the circumstances in other cases, but "by the conditions in the case now before . . ." the Court. *Id.*

V. In the Truth in Lending Act Congress Has Made Specific Provision For Limits on Liability For Violations. This Legislation Pre-empts Any Analysis That Would Otherwise be Made Under *Chevron Oil Co.* v. *Huson.*

Even if this Court determines that there is a case or controversy, Ford Credit is incorrect in asserting that the Court should look to the test set forth in *Chevron Oil Co.* v. *Huson,* 404 U.S. 97 (1971), to determine the scope of applicability of the decision. Congress has mandated liability where a creditor violates TILA, except in carefully specified circumstances reflecting reliance and equitable factors. The Court should not supplant the Congressional determination with a *Chevron* analysis.

TILA provides that "[e]xcept as otherwise provided in this section, any creditor who fails to comply with any requirement . . . with respect to any person is liable to such person . . ." 15 U.S.C. §1640(a). The limitations and exceptions to liability are then set forth. There is a one year statute of limitations. 15 U.S.C. §1640(e). In an individual action statutory damages are set at twice the finance charge with a $100 minimum and a $1000 maximum. 15 U.S.C. §1640(a)(2)(A). In class action cases the judge is given broad discretion in assessing damage ("such amount as the court may allow," based on such factors as the persistence of the conduct and the extent of intent); there is no minimum recovery per class member, and the total recovery may not exceed $500,000 or 1% of the creditor's net worth, whichever is smaller. 15 U.S.C. §1640(a)(2)(B). TILA also provides a defense grounded on the creditor's good faith reliance on official rules, regulations and interpretations of the Federal Reserve Board. 15 U.S.C. §1640(f). These and other provisions in the Act encompass reliance and equity factors analagous to those comprising *Chevron* analysis.

Despite the large proportion of cases this Court decides in which the results were "not clearly foreshadowed," *Chevron,* 404 U.S. at 106, to our knowledge the Court has never applied

a judicial non-retroactivity test, under any formulation, to bar actions where Congress has created a statutory cause of action for damages that contains special limitations on liability. Rather, the Court has applied the test contained in the particular statute, thereby deferring to legislative adjustments of reliance considerations and other equitable factors when the legislature has made such provision.[31]

City of Los Angeles v. *Manhart,* 435 U.S. 702, 718-19 (1978) (denying retroactivity based upon application of an explicit, statutory grant of judicial equitable discretion surrounding the Title VII cause of action). *See also Jimenez* v. *Weinberger,* 523 F.2d 689, 704 (7th Cir. 1975), *cert. denied,* 427 U.S. 912 (1976) (statutory cause of action "adequate" response to request for *Chevron* consideration). Thus the Court implicitly has accepted that the principles it has applied to determining the existence of a cause of action in the first place should also apply to the scope of limitations on the cause of action. The central such principle is that:

> The ultimate question is one of congressional intent, not whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law.

Touche Ross & Co. v. *Redington,* 442 U.S. 560, 578 (1979).[32]

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[31] *Chevron* analysis is appropriate where Congress has not acted to balance claims of reliance and hardship. 42 U.S.C. §1983, for example, creates a cause of action covering a broad expanse of constitutional and statutory issues, and understandably contains no explicit limitations comparable to those in TILA. The Court has treated most remedies under §1983 as equitable remedies subject to *Chevron* analysis. *See Lemon* v. *Kurtzman,* 411 U.S. 192 (1973). *Lemon* is, notably, the only civil case since *Chevron* in which this Court has applied *Chevron.*

[32] If *Chevron*-type tests were universally applicable, there would be a substantial disincentive for Congress to specify legal or equitable limitations on liability. Such decisions should be committed to Congress for policy reasons alluded to in *Cannon* v. *University of Chicago,* 441 U.S. 677, 717 (1979), for preferring that Congress create a specific cause of action rather than leaving it to be implied by the courts.

In TILA Congress has afforded creditors protections similar to, and in certain respects greater than those provided by *Chevron*.[33] These Congressional judgments, effectively preempting the basis for judicial allocation of such interests, should not be augmented judicially.

VI. Even Under the Chevron Test the Ruling of This Court Should Not Be Prospective Only

Applying the three criteria of *Chevron* does not support only prospective application of this Court's decision. Ford Credit meets none of the criteria.

A. THIS COURT'S RULING FOR THE RESPONDENTS WILL NOT ESTABLISH A NEW PRINCIPLE OF LAW.

The first *Chevron* factor is whether the decision has established "a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed," 404 U.S. at 106.[34] This factor is dis-

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See also, id. at 717-18 (Rehnquist, J. concurring); *id.* at 730-731 (Powell, J. dissenting); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568, 574-75, 578-79. When Congress does explicitly create a cause of action, this Court does not apply *Cannon*-type tests to determine if there is an implied cause of action. This Court should not apply a *Chevron* test to imply other limitations on liability.

[33] Ford Credit has not raised here nor could it have raised any objection to relief based on the statutory reliance and equity provisions.

[34] This Court has described a new principle of law meriting solely prospective application as "an avulsive change which caused the current of the law thereafter to flow between new banks," *Hanover Shoe, Inc.*, v. *United Shoe Machine Corp.*, 392 U.S. 481, 499 (1968), or a "clear break with the past," *Desist* v. *United States*, 394 U.S. 244, 248 (1969). *See also Los Angeles Dept. of Water & Power* v. *Manhart*, 435 U.S. 702, 721 (1978) ("[d]rastic changes"). The difference between "overruling clear past precedent" and issues "whose resolution was not clearly foreshadowed" is substantial. Decisions have seldom been given only prospective application based solely on the "not clearly foreshadowed" standard; a reversal of substantial past precedent has normally been present.

positive. If there has been no substantial change in the law, the party seeking to invoke *Chevron* has no equities and there is no reason to consider the other two *Chevron* factors. *Jordan* v. *Weaver*, 472 F.2d 985, 996 (7th Cir. 1976), *rev'd on other grounds sub nom. Edelman* v. *Jordan*, 414 U.S. 651 (1974). An affirmance by this Court would not overrule clear past precedent, nor constitute a decision on an issue of first impression in a manner not clearly foreshadowed.

The Act and Regulation Z have always mandated disclosure of "any security interest." 15 U.S.C. §1638(a)(10); 12 C.F.R. §226.8(b)(5). Regulation Z has always defined "security interest" to include any interest in property which secures payment or performance of an obligation. 12 C.F.R. §226.2(gg). Rulings of the FRB as early as 1970 gave notice that the security interest in returned premiums had to be disclosed. See Section I., *supra*. Case law has also consistently foreshadowed a decision for respondents in this case. Four Circuit Courts of Appeal and numerous other courts have ruled that TILA requires creditors to disclose this security interest. *See* n.10, *supra*.

Ford Credit's attempt to focus the "foreshadowing" issue on the state of the law in 1976, when Valencia and Gonzales signed their contract, is a smokescreen. Ford Credit is not contesting its liability to the respondents. Rather, Ford Credit and its *amici* seek to preclude liability in lawsuits that may be filed after this case is decided. Because of the short TILA statute of limitations, however, such suits would arise out of contracts that post-date not only the Seventh Circuit's decision in this case, but the decision in *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977), and both the decision and the denial of the petition for a writ of *certiorari* in *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979).[35] Even had the

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[35] Ford Credit's *amici* hypothesize a rule that creditors should never have to comply until after the "finality of a decision of a United States Court of Appeals, unless review by this court is sought . . ." (Brief at 29). Since the relief Ford Credit's *amici* seek relates to con-

Seventh Circuit (and the other circuits) applied *Chevron,* Ford Credit would still not have had the protection it seeks here. Thus the request is for protection against failing to follow appellate rulings during the pendency of an unsuccessful appeal. This is a gross distortion of *Chevron's* reliance concepts.[36]

Even if Ford Credit were permitted to base its reliance claim on case law prior to the execution of the contract in this case, the claim would still fail. The first ruling addressing the issue required disclosure and occurred prior to the execution of the contract in this case; the creditor found liable was Ford Credit. *Edmondson* v. *Allen-Russell Ford, Inc., and Ford Motor Credit Co.,* No. C75-940A (N.D. Ga. April 19, 1976), *aff'd,* 577 F.2d 291 (5th Cir. 1978) *cert. denied,* 441 U.S. 951 (1979). As long ago as 1976 prudent creditors were disclosing their security interest in insurance premium refunds. *See Bulger* v. *Thorpe Credit, Inc.,* 609 F.2d 1255, 1257 (7th Cir. 1979). Ford Credit focuses only on two 1976 federal district court decisions, *Gennuso* v. *Commercial Bank & Trust Co.,* 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd* 566 F.2d 437 (3d Cir. 1977), and *Shanks* v. *Greenbriar Dodge, Inc.,* No. C76-1154A (N.D. Ga. 1976), *rev'd on other grounds,* 577 F.2d 296 (5th Cir. 1978). the *Gennuso* decision provides little, if any, support to Ford Credit; it held

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tracts signed after the denial of *certiorari* in *Edmondson,* the *amici* seek more relief than would be obtained under the rule they hypothesize. Even in a situation where the "rule" would apply, it is wrong. It removes any need to comply with provisions of the Act or regulations, or with district court or appellate court decisions; it approves lawlessness and overrides the statutory enforcement scheme; and it creates an incentive to prolong litigation rather than comply with the law. Equally puzzling is the *amici's* view of the merits, those members of *amici* doing business in states where they concede state law requires the disclosure (*amici* Brief at 20 n.42) have been knowingly violating the law for years.

[36] Ford Credit also seeks to preclude liability in 91 pending lawsuits. Its *amici* do not seek to preclude liability in pending lawsuits. Ford Credit does not indicate the date of signing of the contracts in the 91 lawsuits. Presumably a significant portion post-date the decisions by the circuit courts of appeal and arose in such circuits.

that a creditor's interest in unearned physical damage insurance premiums did constitute a TILA security interest.[37] Thus Ford Credit's reliance claim centers solely on the *Shanks* district court decision which was later reversed. Justice Cardozo recognized that reliance on a single trial court decision cannot provide a sufficient predicate for a claim of prospective-only application:

> We will not help out the man who has trusted to the judgment of some inferior court. In his case, the chance of miscalculation is felt to be a fair risk of the game of life, not different in degree from the risk of any other misconception of right or duty. He knows that he has taken a chance, which caution often might have avoided. B. Cardozo, *The Nature of the Judicial Process,* 147-48 (1921).

B. PETITIONERS HAVE FAILED TO DEMONSTRATE THAT NORMAL APPLICATION OF THE DECISION WILL RETARD OPERATION OF THE SECURITY INTEREST DISCLOSURE RULE OF THE *TILA.*

The second factor of the *Chevron* test examines the "prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard operation" of the rule. *Chevron Oil Co.* v. *Huson,* 404 U.S. 97, 104-105 (1971). The burden of showing retardation of the rule is on the party seeking limited application of the decision.[38] *See, Linkletter* v. *Walker,* 381 U.S. 618, 625 (1965); *Great Northern Railway Company* v. *Sunburst Oil & Refining Co.,* 287 U.S. 358, 364 (1932). *Murphy* v. *Ford Motor Credit Co.,* 629 F.2d 556 (8th Cir. 1980), required disclosure of the assignment of returned premiums. Ford Credit failed to persuade the court "that retroactive application of our ruling will impede the op-

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[37] The court's ruling that a TILA security interest could be disclosed on a document separate from other disclosure was reversed.

[38] In *Chevron, supra,* non-retroactive application of this Court's prior holding was predicated on the fact that, because of the anomalous position of the plaintiff himself, applying the holding would actually undermine the core purpose of the new rule of protecting plaintiffs like Huson.

eration of TILA or cause undue hardship or produce inequitable results." *Id.* at 561. The court expressly relied on Congress's intent, in the 1968 Act, to regulate disclosure and encourage the informed use of credit. *Id.* at 560. *See also Valencia* v. *Anderson Bros. Ford,* (J.A. 57).

Neither Ford Credit nor its *amici* argue that the rule of this case will be retarded by "retroactive" application. Rather, they argue that the rule will not be furthered by such application. The argument, however, begs the question. Any award of damages, in any context, by definition does not affect behavior occurring before the award. It is always true that, if the purpose is to affect behavior on the particular issue, "[t]his can only happen as to transactions that have not yet occurred." (*Amici* Brid at 26.) What does affect behavior is the *potential* for damages; it is this potential that Ford Credit and its *amici* seek to eliminate or suspend for whatever periods of time that may follow lower court decisions but precede this Court's decision. The attempt to dilute the potential for damages as a mechanism for furthering operation of TILA and its rules, however, directly contravenes Congress' determination. *See Jimenez* v. *Weinberger,* 523 F.2d 689, 703-04 (7th Cir. 1975), *cert. denied,* 427 U.S. 912 (1976) (statutory cause of action supports conclusion that retroactivity furthers the statutory purpose).

This Court has determined that TILA obligates the consumer credit industry to inform consumers of the terms of credit transactions. *Mourning* v. *Family Publications Service,* 411 U.S. 356, 377 (1973). Criminal procedures and penalties were distinguished from the "modest" civil recovery of TILA, and the Act's reliance on private enforcement. *Id.* at 376.

The Act is designed to correct "the divergent, and at times fraudulent, practices by which consumers were informed of the terms of the credit extended to them." *Id.* at 363. While the Act shifted the burden of disclosure to the credit industry, the burden of enforcement is placed primarily on the private

sector, through civil damages actions. *Mirabel* v. *General Motors Acceptance Corp.*, 576 F.2d 729 (7th Cir. 1978). The Act relies upon creating a system of "private attorneys general" for effective enforcement. Damage actions are intended to encourage debtors to fully enforce their statutory rights. *Thomas* v. *Meyer-Dickson Furniture Co.*, 479 F.2d 740, 748 (5th Cir. 1973).

Recognizing that enforcement of TILA's purposes is dependent upon private civil actions, disclosure requirements should not be applied prospectively only, as that would discourage consumers from asserting their rights under the Act. *Travis* v. *Trust Co. Bank*, 621 F.2d 148, 150 (5th Cir. 1980); *See also Kessler* v. *Associates Financial Serv. Co.*, 573 F.2d 577 (9th Cir. 1977); and *Brown* v. *Termplan, Inc.*, 459 F.Supp. 160 (N.D. Ga. 1978).

Normal judicial application of the requirement to disclose the security interest in unearned insurance premiums will operate to enforce the purposes of the Act. Disembowling the statutory damage provision will only retard compliance with TILA and all of its rules and create an incentive to retain contract provisions that violate the Act.

C. NO INEQUITY IS IMPOSED ON ANY CREDITOR BY FOLLOWING THE GENERAL RULE THAT JUDICIAL DECISIONS APPLY TO PENDING CASES AND CASES BROUGHT WITHIN THE STATUTE OF LIMITATIONS.

The third factor in the *Chevron* test requires the Court to determine whether the normal rule of retroactivity will produce "substantial inequitable results." *Chevron Oil Company* v. *Huson, supra*, 404 U.S. 97 at 107. The test for "substantial inequitable results" has been stringent; only an "impact upon the administration of . . . [the] law so devastating as to need no elaboration," has sufficed. *Tehan* v. *Shott*, 382 U.S. 406, 419 (1966). *See also City of Los Angeles* v. *Manhart*, 435 U.S. 702, 722 (1978) ("devastating harm"); *Gosa* v. *Mayden*, 413 U.S. 665, 685 (1973). The burden of showing such results is on the party claiming that the decision's effect should be lim-

ited, and then the equities must tip "clearly" in his favor. *Jimenez* v. *Weinberger*, 523 F.2d 689, 704 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976).

The equity factor also presupposes that there was a new principle of law established and inquires whether the defendant relied on the prior rule in good faith. *See, United States* v. *Peltier*, 422 U.S. 531, 537 (1975). There is no inequitable result to Ford Credit in the present case[39] because, as demonstrated in Section VI.A, *supra*, no new principle of law was established. Furthermore, Ford Credit's action was a "conscious gamble."[40] *Valencia* v. *Anderson Bros. Ford, supra*, J.A., 57 n.16. Ford Credit and their *amici* now seek to avoid the consequences of their gambles.[41]

The impact of a normal application of the Court's decision will have a minimal effect on the creditors. Some damages under TILA will have to be paid to consumers. Payment of

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[39] The three TILA cases cited by Ford Credit (Ford Brief at 43) are unlike the case at bar. *McDaniel* v. *Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978), and *Ector* v. *Southern Discount Co.*, No. C78-899A (N.D. Ga. Sept. 15, 1980) (Ford Brief, Add. 11-17), gave their new rules prospective application because of reversals of prior decisions on the same issue. *Sneed* v. *Beneficial Finance Co.*, 410 F.Supp. 1135 (D. Hawaii 1976), was effectively reversed in *Kessler* v. *Associates Financial Services Company*, 573 F.2d 577 (8th Cir. 1977) on the non-retroactivity issue.

[40] Ford Credit could have requested an FRB opinion under 12 C.F.R. §226.1(d) and avoided the gamble. Presumably they did not in light of FRB pronouncements contrary to Ford Credit's position, *see* FRB Public Information Letter No. 377, *supra*, and the possibility of asking the courts for non-retroactivity after several years of unsuccessful litigation.

[41] Non-retroactivity in civil litigation has been applied primarily where innocent, relying third parties have been involved, rather than in cases as this in which the perpetrators of an unlawful act claim "inequity." *See, Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), *Lemon* v. *Kurtzman*, 411 U.S. 192 (1973); *Cipriano* v. *City of Houma*, 395 U.S. 701 (1969).

these "modest" statutory damages, *Mourning* v. *Family Publications Services,* 411 U.S. at 376, is entirely appropriate, given the creditors' knowing failure to disclose this security interest. Financial impact alone is an insufficient basis to make a ruling prospective where there is no justifiable reliance. *Cash* v. *Califano,* 621 F.2d 626, 632 (4th Cir. 1980). Further, those damages will be relatively small because 1) the Act provides that a consumer must have a TILA claim adjudicated in a court of competent jurisdiction in order to enforce its damage provision (15 U.S.C. §1640(h)); 2) even when a consumer does have the damage claim adjudicated, the civil liability does not affect any substantive rights under the contract (15 U.S.C. §1610(d)); 3) the Act's brief statue of limitations limits the creditor's potential liability; 4) past experience shows that few consumers litigate this claim; and 5) the amount of damages the creditors may pay is insignificant compared to the benefit the creditors have reaped by hiding the clause.

1. Ford Credit contends that the Court's decision will "affect" the many outstanding contracts of Ford Credit and its *amici.* Ford Brief at 42. This is not true. The Act provides that the creditor's liability for a violation must be determined by a court of competent jurisdiction in an action to which such person was a party. 15 U.S.C. §1640(h).

2. The substantive rights under the contract are unaffected even where the civil damages are adjudicated in court. 15 U.S.C. §1610(d). The creditor's contractual rights to require payment, repossess the automobile upon default, cancel insurance and take the unearned insurance premiums, and all other substantive rights, remain enforcable whether or not a TILA damage claim has been adjudicated.

3. The one-year statute of limitations will quickly cut off Ford Credit's future exposure, if it has not done so already. Ford Credit modified its contract to comply with TILA in some regions as early as July, 1978. *See* Response to Ford Credit Cert. Pet., at 4, *Ford Motor Credit Company* v. *Edmondson,* No. 78-1072, *cert. denied,* 441 U.S. 951 (1979).

The new Ford Credit contract in Illinois was evidently in place as early as June, 1979. See Add. 2, lower left-hand corner. The statute of limitations on prior contracts will have run for affirmative TILA actions by the time this Court rules.

4. Ford Credit's past experience shows that few consumers litigate this claim. While Ford Credit's failure to disclose has been declared to violate TILA regarding the violation in question in the Third, Fifth, Seventh, and Eighth Circuits, and Ford Credit itself says there were millions of offending contracts over the years, there are only 91 claims regarding this violation pending against Ford Credit nationwide.[42] Ford Credit Cert. Pet. at 15. Even as to those creditors who did not modify their contracts in response to the various circuit court decisions, there is no reason to believe the result in this case will cause consumers to flock to court to make this claim. The incentive to file suit was as great before the ruling in this case. Moreover, the courts should not tolerate creditors perpetuating the use of a non-complying contract, thereby increasing the number of violations of the Act, and then attempting to rely on the increased number of potential plaintiffs as a ground for non-retroactive application.

5. The amount of damages the creditors may have to pay for hiding the clause is insignificant when compared to the benefits they have received under the clause. For example, it is indisputable that creditors have used large amounts of the undisclosed security over the years. If insurance premiums average $200 in a typical automobile transaction, and Ford Credit's exercise of its security interests is randomly distributed in time, the undisclosed security interest has allowed Ford Credit to take an average of an extra $100 in every default over the years. If Ford Credit has 10,000 reposses-

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[42] Ford Credit's *amici* concede that pending cases should not be barred by "prospective application," Brief at 29.

sions in an average year,[43] Ford Credit has actually recovered at least $10 million in undisclosed security interests in the last ten years. Such amounts dwarf any potential TILA exposure that non-disclosing creditors may face.

Finally, the damages Ford Credit may pay as the result of normal retroactive application of the Court's decision when compared with its net worth does not produce a substantial inequitable result. The damages from the 91 pending lawsuits[44] and the few additional suits which may be filed, if Ford Credit has not in fact modified its contract in other jurisdictions, are paltry in comparison to its total assets of $1.5 billion and net income of $153 million in 1979. Ford Motor Credit Company Form 10-K filed with the Securities Exchange Commission for Fiscal Year ending December 31, 1979. Commission File No. 1-6368.

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[43] This estimated figure is based on Ford's 1979 Form 10-K statement filed with the Securities Exchange Commission. Commission File No. 1-6368. Ford stated the value of its repossessed cars in 1979 at $39 million. Estimating the value of each car at $3,900, 10,000 cars a year are repossessed. In 1977 Ford Credit's *amici* General Motors Acceptance Corporation repossessed over 46,000 automobiles. Federal Trade Commission, Report of the Presiding Officer on Proposed Trade Regulation Rule: Credit Practices, 16 C.F.R. Part 444, Public Record 215-42 at 217.

[44] One of these was filed as a class action. The court in that case had broad equitable authority under TILA itself to consider fully the equitable defenses Ford Credit attempts to assert here. 15 U.S.C. §1640(a)(2)(B). Similarly "the potential for enormous liability in class actions" claimed by *amici* (Brief at 4) is illusory, since it is curbed by the statutory discretion. Ford Credit's liability for damages in the other 90 pending cases cannot exceed $90,000. 15 U.S.C. §1640(a)(2)(A).

CONCLUSION

For the reasons stated above, respondents respectfully request this Court to affirm the judgment of the Court of Appeals below.

Respectfully submitted,

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ADDENDUM

FEDERAL RESERVE press release

For immediate release November 28, 1980

The Federal Reserve Board today issued revised proposals for simplifying its Regulation Z, which implements the Truth in Lending, Fair Credit Billing and Consumer Leasing Acts.[1]

The Board requested comment by January 19, 1981.

The Board's proposals are a complete overhaul, restructuring and further simplification of proposals made in May taking into account comment received on the May proposals.

* * * *

Attachment 2

Questions on Which the Board Particularly Requests Comment

Definitions

5. Should a security interest be defined more narrowly than under the current regulation, to exclude a number of incidental property interests such as accessions, accessories and interests in insurance and unearned insurance proceeds? (§226.2)

GUARANTY

To cause the Seller to sell the Vehicle described on the front of this contract to the Buyer, on credit, each of the persons who signs below as a "Guarantor" guaranties the payment of this contract. This means that if the Buyer fails to pay any money that is owed on this contract, each one who signs as a guarantor will pay it when asked. Each person who signs below agrees that he will be liable for the whole amount owed even if one or more other persons also signs this Guaranty. He also agrees to be liable even if the Creditor does one or more of the following: (a) gives the Buyer more time to pay one or more payments, or (b) gives a release in full or in part to any of the other Guarantors, or (c) releases any security. Each Guarantor also states that he has received a completed copy of this contract and this Guaranty at the time of signing.

Guarantor _____ Address _____

Guarantor _____ Address _____

ASSIGNMENT

The seller (hereinafter called Seller) named on the face of the within contract (hereinafter called the Contract) sells, assigns and transfers to Ford Motor Credit Company (hereinafter called Ford Credit) Seller's entire right, title and interest in and to the Contract and the property (hereinafter called the Property) described therein and authorizes Ford Credit to do every act and thing necessary to collect and discharge obligations arising out of or incident to the Contract and this Assignment. In order to induce Ford Credit to accept assignment of the Contract, Seller warrants that: the Contract, and guaranty, if any, are genuine, legally valid and enforceable and arose from the sale of the Property; the Property is as represented to the buyer (hereinafter called Buyer) named therein who was quoted both a deferred payment price and a lesser cash price; the Contract was complete in all respects and Seller made all disclosures required by law, and in the manner required by law, prior to the execution thereof by Buyer; Buyer is not a minor, has capacity to contract and paid the downpayment stated in the Contract with his own funds; all statements made by or on behalf of Buyer and furnished to Ford Credit by Seller are true to the best of Seller's knowledge and belief, and Seller has no knowledge of any fact that would impair the validity or value of the Contract; title to the Property is vested in Seller free of all liens and encumbrances and Seller has the right to assign said title; and a certificate of title to the Property showing a lien or encumbrance for the benefit of Ford Credit or Seller has been or will be applied for forthwith if permitted by law. If there is any breach of any of the foregoing warranties, without regard to Seller's knowledge or lack of knowledge with respect thereto or Ford Credit's reliance thereon, Seller hereby agrees unconditionally to purchase the Contract from Ford Credit, upon demand, for the full amount then unpaid whether the Contract shall then be, or not be, in default. Seller further agrees that in the event Buyer or any other person makes a claim against Ford Credit alleging facts which, if true, would constitute a breach of any of the foregoing warranties, Seller shall assume the defense of such claim and shall indemnify and save Ford Credit harmless from all loss, cost and expense arising therefrom. In addition, this Assignment includes the provisions of the paragraph initialed below by Seller; provided, that if none of the paragraphs below has been initialed by Seller, this Assignment shall include the provisions of the paragraph below entitled "Repurchase". The liability of Seller shall not be affected by any extension, renewal or other change in the time of payment of the Contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof or the release or non-perfection of any security thereunder. Ford Credit shall not be bound to exhaust its recourse against Buyer or any other person or any security Ford Credit may at any time have before being entitled to payment from Seller hereunder. Seller waives notice of the acceptance of this Assignment and notices of non-payment and non-performance of the Contract and any other notices required by law and waives all setoffs and counterclaims. This Assignment shall become effective upon delivery of the Contract to Ford Credit or upon Ford Credit's payment of the purchase price therefor, whichever first occurs.

Initial "WITHOUT RECOURSE" This Assignment of the Contract is and shall be without recourse against Seller, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective.

Initial "REPURCHASE" Seller guaranties payment of the full amount remaining unpaid under the Contract and covenants if default be made in payment of any instalment thereunder to pay the full amount then unpaid to Ford Credit, upon demand, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective.

Initial "LIMITED REPURCHASE" Seller guaranties payment of the full amount remaining unpaid under the Contract and covenants if default be made in payment of any instalment thereunder to pay the full amount then unpaid to Ford Credit, upon demand, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective; provided, that if Buyer satisfactorily pays the number of instalments under the Contract specified in the Ford Credit Retail Plan, this Assignment shall thereafter be without recourse against Seller, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective.

Initial "PARTIAL GUARANTY" Notwithstanding the terms of the Ford Credit Retail Plan, Seller unconditionally guaranties payment of the full amount remaining unpaid under the Contract, and agrees to purchase the Contract from Ford Credit, upon demand, for the full amount then unpaid whether the Contract shall then be, or not be, in default; provided, that at the time of any such demand by Ford Credit, Seller may, at his election, pay to Ford Credit the sum of $ _____ in consideration of being released from such guaranty obligation, and in such event, this Assignment of the Contract is without recourse against Seller, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective.

Initial "LIMITED TERM REPURCHASE" Seller guaranties payment of the full amount remaining unpaid under the Contract, and covenants if default be made in payment of any instalment thereunder to pay the full amount then unpaid to Ford Credit, upon demand, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective; provided, that if Buyer satisfactorily pays each of the first _____ instalments coming due under the Contract, this Assignment shall thereafter be without recourse against Seller, except as otherwise provided by the terms of the Ford Credit Retail Plan in effect at the time this Assignment becomes effective.

Initial "FULL GUARANTY" Notwithstanding the terms of the Ford Credit Retail Plan, Seller unconditionally guaranties payment of the full amount remaining unpaid under the Contract and agrees to purchase the Contract from Ford Credit, upon demand, for the full amount then unpaid whether the Contract shall then be, or not be, in default.

Initial "FORD DEALER RETAIL TRUCK FINANCE PLAN" Except for breach of any of the foregoing warranties this Assignment shall be governed by the "Ford Dealer Retail Truck Financing Agreement" heretofore executed by Ford Credit and Seller.

Initial "FORD FLEET TRUCK FINANCE PLAN" Except for breach of any of the foregoing warranties this Assignment shall be governed by the "Truck Fleet Sales Financing Agreement" between Ford Credit and Ford Motor Company, dated September 19, 1960, and a "Dealer Truck Financing Agreement" between Seller and Ford Motor Company, dated _____

ACCT. NO. _____ **ILLINOIS AUTOMOBILE RETAIL INSTALLMENT CONTRACT** DATE _____

Buyer (and Co-Buyer)-Name and Address (Include County and Zip Code)	CREDITOR Seller-Name and Address
"Buyer" means all persons who sign this Contract as Buyer or Co-Buyer	Assignee of Contract (See Assignment below): Ford Motor Credit Company, The American Road, Dearborn, Michigan 48121

The Buyer may buy the Vehicle described below for cash. The cash price is shown below in Item (1) "Cash Price". He may also buy the Vehicle on credit. The credit price is shown below in Item (10) "Deferred Payment Price". By signing this contract, the Buyer chooses to buy the Vehicle on credit under the agreements in this contract. **In this contract there is no promise as to the merchantability, suitability, or fitness for purpose of the Vehicle.** The Buyer may receive a separate warranty on the Vehicle.

New or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Vehicle Identification Number	Use For Which Purchased
							☐ Personal ☐ Agriculture ☐ Business ☐

INCLUDING:
☐ Radio ☐ Air Conditioner ☐ Automatic Transmission ☐ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☐ _____

DESCRIPTION OF TRADE-IN:
_____ (Year and Make) _____ (Serial Number) $ _____ (Gross Allowance) $ _____ (Amount Owing)

ADDITIONAL PROVISIONS

A. Vehicle Ownership, Use and Care: The Buyer will take care of the Vehicle and will obey all laws in using it. The Buyer will not sell the Vehicle and will keep it free from the claims of other persons. The Buyer will use the Vehicle only in the state where he now lives unless the Creditor gives him written consent to use it in another state or unless his use of the Vehicle in another state is for no more than one month.

B. Vehicle Insurance: The Buyer will insure the Buyer and the Creditor against loss or damage to the Vehicle. The type and amount of insurance must be acceptable to the Creditor. The Creditor may buy the insurance if the Buyer does not, but the Creditor does not have to do so. If the Creditor buys the insurance, the Creditor may insure only the Creditor or both the Creditor and the Buyer. In either case, the Buyer must pay back to the Creditor what the Creditor pays for the insurance plus interest at the highest rate allowed by law. If the Creditor insures only the Creditor, the Buyer will not have insurance. Whether or not the Vehicle is insured, the Buyer must pay for it if it is lost, damaged or destroyed.

If a charge for insurance is shown below, the Creditor will try to buy the coverages checked for the term shown. The Creditor is not liable though if he cannot do so. If these coverages cost more than the amount shown for insurance, the Creditor may buy them for a shorter term or he may credit the Buyer for the amount shown for insurance. If the Creditor cannot buy any insurance, he will credit the Buyer for the amount shown for insurance. The credit will be made to the last payments due. If the Creditor does not buy the insurance, the Buyer must buy it.

☐ Comprehensive
☐ Fire-Theft & Combined Additional Coverage
☐ Towing & Labor Costs ($25.00 Limit)
☐ $ _____ Deductible Collision

Term: _____ Months $ _____

DETAILS OF TRANSACTION

(1) Cash Price		$ _____ (1)
Cash Downpayment	$ _____	
Trade-In (Description above)	$ _____	
(2) Total Downpayment		$ _____ (2)
(3) Unpaid Balance of Cash Price (Item (1) minus (2))		$ _____ (3)
(4) Other Charges		
Vehicle Insurance	$ _____	
Credit Life Insurance	$ _____	
Credit Disability Insurance	$ _____	
Official Fees	$ _____	
Taxes (Not in Cash Price)	$ _____	
License ($ _____),		
Title ($ _____), and		
Registration ($ _____) Fees	$ _____	
_____	$ _____	
_____	$ _____	
_____	$ _____	
Total Other Charges		$ _____ (4)
(5) Unpaid Balance – Amount Financed (Items (3) plus (4))		$ _____ (5)
(6) FINANCE CHARGE		$ _____ (6)
(7) ANNUAL PERCENTAGE RATE _____ % (7)		
(8) Total of Payments (Items (5) plus (6))		$ _____ (8)

(9) **Payment Schedule:** The Buyer will pay the Total of Payments (Item 8) to the Creditor in _____ monthly payments. Each payment, except the last one, will be $ _____. The last payment will be $ _____. Payments are due on the _____ day of each month. The first payment is due on _____, 19 _____.

☐ Comprehensive
☐ Fire-Theft & Combined Additional Coverage
☐ Towing & Labor Costs ($25.00 Limit)
☐ $ _____ Deductible Collision

Term: _____ Months $ _____

The Buyer may choose the person through whom Vehicle Insurance is to be obtained.

Liability insurance coverage for bodily injury and property damage caused to others is not included.

C. Credit and Other Optional Insurance:

(1) Credit Life Insurance by

_____

on the life of _____

_____

This insurance is for the term of this contract and is explained in a notice or agreement given to the Buyer on this date. $ _____

(2) Credit Disability Insurance by

_____

This insurance is for the term of this contract and is explained in a notice or agreement given to the Buyer on this date. $ _____

(3) Other Optional Insurance
(Describe and specify term)

_____ $ _____

_____ $ _____

Credit Life Insurance, Credit Disability Insurance and Other Optional Insurance is not required by the Creditor and is not a factor in the Creditor's decision to approve this credit. Credit Life Insurance or Credit Disability Insurance may be cancelled from its inception within 15 days from the date hereof by written request from each Buyer and any Guarantor. Upon cancellation, the entire charge therefor shall be refunded or credited to Buyer.

The Buyer asks the Creditor to buy the insurance for which an amount is shown above.

Buyer _____ Date _____

_____

(Cost of insurance to be included only if signed by each insured Buyer and dated)

(8) Total of Payments (Items (5) plus (6)) $ _____ **(8)**

(9) Payment Schedule: The Buyer will pay the Total of Payments (Item 8) to the Creditor in _____ monthly payments. Each payment, except the last one, will be $ _____. The last payment will be $ _____. Payments are due on the _____ day of each month. The first payment is due on _____, 19 _____.

(10) Deferred Payment Price (Items (1) plus (4) plus (6)) $ _____ **(10)**

(11) Security Interest: The Buyer gives the Creditor a security interest under the Uniform Commercial Code in the Vehicle, in all money or goods received for the Vehicle and in all insurance charges financed for the Buyer. This secures the payment of the monthly payments and all other amounts the Buyer now or later owes on this contract. It also secures the Buyer's other agreements in this contract.

(12) Prepayment Rebate: The Buyer may pay this contract in full at any time. If he does so, he will get a credit for the unearned part of the Finance Charge if it is **$1.00** or more. This credit will be figured on the sum of the digits method after first subtracting **$25.00.**

(13) Late Charges: The Buyer will pay a late charge on each payment not made within **10** days after it is due. The charge is **5** per cent of the part of the payment that is late, or **$5.00,** whichever is less. The Buyer also will pay any cost paid by the Creditor to collect any late payment. The Creditor's acceptance of any late payment or late charge does not excuse the Buyer's default or mean that the Buyer can keep making payments after they are due. The Creditor may accelerate the remaining payments and repossess the Vehicle, as explained below, if there is any default.

(14) Default: If the Buyer fails to make any payment when it is due, or if he fails to keep any other agreement in this contract, the Creditor may do either or both of the following:

a. Acceleration of Payments: The Creditor may require the Buyer to pay at once all remaining payments. The Buyer will receive a prepayment rebate as explained above when he pays.

b. Repossession: The Creditor may repossess the Vehicle. The Creditor may also take goods found in or on the Vehicle and hold them for the Buyer. If the Vehicle is taken back, the Creditor will send a notice to the Buyer. The notice will state that the Buyer may redeem (buy back) the Vehicle. It will also show the amount needed to redeem. The Buyer may redeem the Vehicle up to the time the Creditor sells it or agrees to sell it. If the Buyer does not redeem the Vehicle, it will be sold. The money from the sale, less allowed expenses, will be used to pay the amount still owed on this contract. Allowed expenses are those paid as a direct result of having to retake the Vehicle, hold it, prepare it for sale and sell it. Lawyers' fees and legal costs are allowed too. If there is any money left (a surplus), it will be paid to the Buyer. If the money from the sale is not enough to pay off this contract and costs, the Buyer will pay what is still owed to the Creditor, if allowed by law.

(15) General: Any change in this contract must be in writing and signed by the Buyer and the Creditor. The law of Illinois applies to this contract. If that law does not allow all of the agreements in this contract, the ones that are not allowed will be void. The rest of this contract will still be good.

Notice to the buyer.

1. **Do not sign this agreement before you read it or if it contains any blank spaces.**
2. **You are entitled to an exact copy of the agreement you sign.**
3. **Under the law you have the right, among others, to pay in advance the full amount due and to obtain under certain conditions a partial refund of the finance charge.**

Buyer acknowledges receipt of a true and completely filled in copy of this contract at the time of signing.

RETAIL INSTALLMENT CONTRACT

Buyer Signs _____ (Co) Buyer Signs _____

Guarantor Signs _____

I hereby guarantee the collection of the above described amount upon failure of the seller named herein to collect said amount from the buyer named herein.

Assignment: The Seller accepts this contract. If no other Assignee is named at the top of this contract the Seller assigns it to Ford Motor Credit Company under the Assignment on the back of this contract. If another Assignee is named, the Seller assigns this contract to the other named Assignee under the Assignment attached to this contract. When the Assignee buys this contract, it will be the Creditor.

Seller _____ By _____ Title _____

NOTICE – ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

November 24, 1980

Enclosed are final versions of the following official staff interpretations of Regulation Z issued since the last mailing in March: FC-0169, FC-0170, and FC-0172. Notices of activity on official staff interpretations not yet finalized (FC-0171 and FC-0173), as well as a revised version of FC-0159 reflecting an additional extension of the letter's termination date, are being sent. Also enclosed is the one official staff interpretation of Regulation B, EC-0015, issued since the last mailing.

* * * *

12 CFR Part 226, FC-0173

FC-0173, a proposed official staff interpretation regarding security interest disclosures in closed end credit transactions was published for comment on September 24, 1980 (45 FR 63295). The comment period ended October 24, 1980. This proposed interpretation may not be relied upon until final action is taken.

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No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

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FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF THE PETITIONERS

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* Anderson Bros. Leasing and Wayne H. Anderson Insurance Agency may be considered affiliates of Anderson Bros. Ford.

**Ford Motor Credit Company is a wholly owned subsidiary of Ford Motor Company. All subsidiaries of Ford Motor Credit Company are either wholly owned by Ford Motor Credit Company or are wholly owned by Ford Motor Credit Company and other subsidiaries of Ford Motor Company. Ford Motor Credit Company may be considered an affiliate of the subsidiaries of Ford Motor Company listed in Appendix C.

TABLE OF CONTENTS

	PAGE
Table of Contents	ii
Table of Authorities	iii
Argument	1
I. CONGRESS NEVER INTENDED TO REQUIRE DISCLOSURE OF THE ASSIGNMENT PROVISION	2
A. In Order to Ascertain the Intent of Congress, It is Necessary to Look to the Legislative History	2
B. The Legislative History of the Act Demonstrates that Congress Did Not Intend to Require Disclosure of this Incidental Interest	3
C. The Legislative History of the Simplification Act Confirms that Congress Intended Not to Require Disclosure of the Assignment Provision	6
II. THE FEDERAL RESERVE BOARD DOES NOT REQUIRE DISCLOSURE OF THE ASSIGNMENT PROVISION UNDER THE PRESENT ACT AND REGULATION	9
III. A DECISION BY THIS COURT REQUIRING DISCLOSURE OF THE ASSIGNMENT PROVISION SHOULD BE GIVEN ONLY PROSPECTIVE APPLICATION	12
Conclusion	16
Appendices	
A. Letter dated January 23, 1981 from Paul A. Volcker, Chairman of the Board of Governors of the Federal Reserve System	A-1
B. Memorandum of the Board of Governors of the Federal Reserve System dated November 9, 1979	A-2
C. List of Subsidiaries of Ford Motor Company	A-14

TABLE OF AUTHORITIES

Cases

	PAGE
Austin Co. v. United States, 314 F.2d 518 (Ct. Cl. 1963)	5
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	13, 14
Donovan v. United States, 580 F. 2d 1203 (3d Cir. 1978)	5
Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979)	15
Federal Energy Admin. v. Algonquin SNG, Inc., 426 U.S. 548 (1976)	4
Ford Motor Credit Co. v. Milhollin, 444 U.S. 555 (1980)	6, 7, 8
GTE Sylvania v. Consumer Product Safety Commission, 598 F.2d 790 (3d Cir. 1979), *aff'd*, 447 U.S. 102 (1980)	12
Harrington v. Vandalia-Butler Board of Education, 585 F.2d 192 (6th Cir. 1978)	5
Harris v. Brown, 470 F. Supp. 250 (W.D. Mo. 1979)	12
Pipefitters Local Union No. 562 v. United States, 407 U.S. 385 (1972)	7
Plant v. Blazer Financial Services, Inc., 598 F.2d 1357 (5th Cir. 1979)	14
Skidmore v. Swift & Co., 323 U.S. 134 (1974)	12
Stovall v. Denno, 388 U.S. 293 (1967)	13
United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975)	2
United States v. American Trucking Assn., 310 U.S. 534 (1940)	2
United States v. Donruss Co., 393 U.S. 297 (1969)	3
United States v. Exxon Corp., 87 F.R.D. 624 (D.D.C. 1980)	12
United Steelworkers v. Weber, 443 U.S. 193 (1979)	3

Statutes

	PAGE
Consumer Credit Protection Act, 15 U.S.C. § 1640(a)(1)	14
Consumer Credit Protection Act, 15 U.S.C. § 1640(f)	11
Truth in Lending Simplification and Reform Act, P.L. 96-221, Title VI, 94 Stat. 168	6-9

Regulation Z and Federal Reserve Board Interpretations

Regulation Z, 12 C.F.R. § 226.1(d)(2)(1980)	11
Regulation Z, 12 C.F.R. § 226.2(gg)(1980)	4
Federal Reserve Board Public Information Letter No. 377 (1970)	9
Official Staff Interpretation FC-0172, 45 Fed. Reg. 41437 (June 19, 1980) (proposed), 45 Fed. Reg. 62976 (Sept. 23, 1980)(adopted)	10
Proposed Official Staff Interpretation FC-0173, 45 Fed. Reg. 63295 (Sept. 24, 1980)	9-12
Proposed Revision of Regulation Z, 45 Fed. Reg. 80647 (Dec. 5, 1980)	7

Other

Comment, *Security Interests in Insurance Proceeds and Unearned Premiums—Have the Courts Gone too Far with Truth in Lending?*, 41 Louisiana L. Rev. 175 (1980)	7
Edmonds and Taylor, *Truth and Consequences*, 35 Wash. & Lee L. Rev. 367 (1978)	12
Garwood, *Truth in Lending—A Regulator's View*, 29 Bus. Law. 193 (1973)	5
1 G. Gilmore, *Security Interests in Personal Property* § 11.1 (1965)	3
The Wall Street Journal, Feb. 20, 1981 at 4, col. 1	15

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Respondents.

REPLY BRIEF OF THE PETITIONERS

ARGUMENT

Petitioners[1] submit this reply brief to respond to the arguments raised by Respondents. The principal issue in this case is whether the assignment of unearned insurance premiums is a "security interest" required to be disclosed under the Truth in Lending Act (the "Act"). For the first seven years of the Act's relatively short life, no one—lender or borrower—imagined that the Act could be strained to require such disclosure. As demonstrated by the brief filed herein by the credit industry *amici* (the "Industry

[1] The Petitioners, Anderson Bros. Ford and Ford Motor Credit Company, are hereinafter referred to jointly as "Ford Credit", and the Brief of the Petitioners filed herein is referred to as "Ford Br."

Amici"),[2] the credit industry (which deals with security interests as its stock in trade) uniformly has regarded the assignment provision as not being a security interest. The legislative history of the Act, Congressional enactments in the field since adoption of the Act, and recent pronouncements from the staff of the Board of Governors of the Federal Reserve System (the "Board") all support this interpretation of the Act. This Court should confirm it.

I. CONGRESS NEVER INTENDED TO REQUIRE DISCLOSURE OF THE ASSIGNMENT PROVISION.

A. In Order to Ascertain the Intent of Congress, It is Necessary to Look to the Legislative History.

The fundamental objective in construing a federal statute is to ascertain the intent of Congress. *United States* v. *American Trucking Assn.*, 310 U.S. 534, 542 (1940). Yet Respondents make no attempt to ascertain what Congress actually intended; instead, they choose to focus myopically on a word-by-word parsing of the Act and Regulation. To be sure, a question of interpretation does not arise where the language of a statute "is plain and admits of no more than one meaning." (Resp. Br. 8). But that is not the case here. Respondents' "plain language" argument that "any security interest" must be disclosed (Resp. Br. 7) begs the question of whether the assignment provision at issue here *is* a "security interest".[3] The concept of what constitutes a

[2] Brief of the Consumer Bankers Association, General Motors Acceptance Corporation and the National Consumer Finance Association as *amici curiae* ("Industry Br.") at 7-8.

[3] *Compare United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975) (although definition of "security" in the federal securities laws includes "any . . . stock," shares of stock in a cooperative housing project did not constitute "securities" within the meaning of those laws).

security interest is amorphous and impossible to define with precision. 1 G. Gilmore, *Security Interests in Personal Property* § 11.1, at 334-35 (1965). The courts are divided on this issue (Ford Br. 24, n.9), and a proposed Official Staff Interpretation recently published by the staff of the Board expressly rejects Respondents' reading of the Act. Thus, resort must be had to the legislative history in order to reveal the true Congressional intent in this case. *United States* v. *Donruss Co.*, 393 U.S. 297, 303 (1969).

B. The Legislative History of the Act Demonstrates that Congress Did Not Intend to Require Disclosure of this Incidental Interest.

The overall purpose of the Act—to facilitate comparison shopping for credit by requiring uniform disclosure of credit terms—would be frustrated rather than advanced by requiring the assignment provision to be disclosed as a security interest. (Ford Br. 10, 16-19). It is fundamental that a statute must be construed in accordance with its purpose. *United Steelworkers* v. *Weber*, 443 U.S. 193, 201 (1979).

The legislative history of the Act's security interest provision supports this result. That provision was added to the Act as an amendment from the floor of the House of Representatives by Congressman Cahill, who explained that it was designed to prevent certain deceptive practices in credit transactions in which the borrower takes out a second mortgage on his home to secure the loan. This view was echoed in the Senate when the security interest amendment was introduced by Senator Proxmire. (Ford Br. 11-12). No Congressman voiced dissent or suggested that the security interest amendment was intended to require disclosure of less fundamental interests. This Court has consistently given "substantial weight" to such un-

challenged statements by an amendment's sponsor on the floor of Congress.[4] *Federal Energy Admin.* v. *Algonquin SNG, Inc.*, 426 U.S. 548, 564 (1976).

When these statements are read in conjunction with the Act's purpose of permitting consumers to comparison shop for credit, it is clear that the security interest provision was added to the Act so that a borrower would be told when he was putting such critically important interests as his home at risk if he should fail to repay the loan. Thus, although security interests other than home mortgages must be disclosed under the Act, Congress was concerned only with interests in property which (i) are intended primarily to satisfy the debt when liquidated upon default and (ii) are of such importance to a borrower that they would realistically influence his decision in shopping for credit. The right to receive unearned premiums is not that sort of interest.[5]

The definition of "security interest" in Regulation Z, 12 C.F.R. § 226.2(gg), also supports this distinction. The

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[4] Respondents argue that Congressman Cahill's and Senator Proxmire's statements should not be considered since they were not "precise" analyses of the amendment. (Resp. Br. 7, n.4). Besides ignoring the substantial weight given by case law to comments by the sponsor of such an amendment as to legislative purpose, Respondents miss the central point that this provision was added from the floor of Congress and was not discussed in the committee reports. These floor statements thus comprise the *only* legislative history available to us in ascertaining the intent of Congress.

[5] Accusing Ford Credit of mischaracterizing its own contract, Respondents argue that the purpose of the assignment provision is to provide additional security for the debt rather than to protect Ford Credit from the risk of uninsured collateral. (Resp. Br. 10, n. 6). This unsupported statement simply is not true. The assignment provision is needed to eliminate the debtor's incentive to cancel the property damage insurance in order to recover the unearned premium.

list of examples set out in the definition all relate to interests designed to secure payment of the debt. The definition does *not* include any example of an interest comparable to the one at issue here, which is, at most, tangentially related to payment of the debt. (Industry Br. 10, n. 20). Therefore, under the doctrine of *ejusdem generis*, the assignment provision should not be regarded as fitting within the definition. Contrary to the Respondents' argument (Resp. Br. 15), courts have applied *ejusdem generis* in cases involving introductory language such as "including, but not limited to . . ." which appears in the Regulation Z definition. *Donovan* v. *United States*, 580 F.2d 1203, 1207 (3d Cir. 1978); *Harrington* v. *Vandalia-Butler Board of Education*, 585 F.2d 192, 195 (6th Cir. 1978); *Austin Co.* v. *United States*, 314 F.2d 518, 520 (Ct. Cl. 1963).

Noting that the annual premium to be paid for property damage insurance in this case was $215,[6] Respondents

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[6] In fact, purporting to rescind the contract, Respondents never paid any insurance premiums. (Rec. Doc. No. 33 at 46). Thus, no unearned insurance premiums ever came into being in this case. Moreover, in any individual case, the average value of the real and fully disclosed security interest—the financed vehicle—dwarfs the relatively *de minimus* interest in unearned property damage insurance premiums. Providing co-equal disclosure of such interests will not aid comparison credit shopping. As noted in an article analyzing the development of Truth in Lending law by the member of the Board's staff principally responsible for its Truth in Lending function:

> *[T]he Board is constantly faced with the conflict between complete disclosure and customer confusion . . . . The more information the creditor discloses, the less the customer may learn about the credit plan.* Consequently, the Board must search for that point at which increased disclosure begins to decrease customer enlightenment.

Garwood, *Truth in Lending—A Regulator's View*, 29 Bus. Law. 193, 199 (1973) (emphasis supplied).

argue that the assignment provision is of substantial importance to consumers and thus ought to be disclosed prominently by lenders. (Resp. Br. 18-20). But this argument proves too much. Under the Act, certain specified terms are required to be disclosed on the "disclosure statement" (*i.e.*, on the face of the contract). Other contractual terms need not be so disclosed, regardless of their importance to the borrower.[7] Respondents' argument would subvert the statutory scheme by requiring disclosure, on the face of the contract, of all arguably important contractual terms.

C. The Legislative History of the Simplification Act Confirms that Congress Intended Not to Require Disclosure of the Assignment Provision.

Ford Credit's initial brief demonstrates that disclosure of the assignment provision is not required under the Truth in Lending Simplification and Reform Act, P. L. 96-221, Title VI, 94 Stat. 168 (the "Simplification Act"). (Ford Br. 19-21).[8] Contrary to the suggestion of Respondents (Resp. Br. 23-24), Ford Credit does not contend that the Simplification Act, which will not become effective until April 1, 1982, directly governs this case. Instead, Ford Credit contends that the Simplification Act provides a "cross light" which clarifies existing law with respect to this issue and helps to determine Congress' original intent

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[7] In *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), for example, this Court rejected the argument that the acceleration clause had to be disclosed on the face of the contract. The acceleration clause, which permits the creditor to declare the full contract balance immediately due and payable, is obviously of much greater importance to consumers than the assignment provision at issue here.

[8] This point is not seriously disputed by the Respondents, although they find it "premature" to consider the issue. (Resp. Br. 25, n. 22).

in requiring the disclosure of security interests. *See Pipefitters Local Union No. 562* v. *United States*, 407 U.S. 385, 411-13 (1972), and cases cited therein.[9]

Apparently conceding that the assignment provision would not have to be disclosed as a security interest under the Simplification Act, Respondents argue that such result reflects a change in the present Act rather than merely a clarification. (Resp. Br. 25-26). In support of their argument, they note that the legislative history contains statements that Congress was intending to simplify and improve the present Act. To be sure, the Simplification Act encompasses many purposes, including both changes in and clarifications of the law in a number of areas. The Board has carefully analyzed the provisions of the Simplification Act in the process of developing implementing regulations which Congress directed the Board to have in place by April 1, 1981. According to the Board's analysis, the effects of the Simplification Act can be put into five categories, including the clarification of "certain complex legal questions that produced conflicting court decisions in the past." Proposed Revision of Regulation Z, 45 Fed. Reg. 80647, 80731 (Dec. 5, 1980). The Board specifically noted that one of the legal issues which was clarified by the Simplification Act is "adequate disclosure of security interests." *Id.* at 80733.[10]

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[9] This Court in *Milhollin* used the legislative history of the Simplification Act as an aid in interpreting the statutory scheme. *See* 444 U.S. at 568. *See also* Comment, *Security Interests in Insurance Proceeds and Unearned Premiums—Have the Courts Gone too Far with Truth in Lending?*, 41 Louisiana L. Rev. 175, 189-91 (1980).

[10] This precise analysis of the effects of the Simplification Act clearly represents the Board's position, as opposed to the ambiguous wording of the press release upon which Respondents rely. (Resp. Br. 18; Resp. Br. Add. 1).

Respondents also attack the reliability of Senator Garn's statement in the Congressional Record quoted in Ford Credit's initial brief (Ford Br. 21), which unequivocally supports Ford Credit's position that the assignment provision was not intended to be disclosed as a security interest under the original Act. Respondents argue that Senator Garn's statement "contradicts" the committee reports as to the purpose of the Simplification Act. (Resp. Br. 27).[11] However, there is no such contradiction. Nothing in the committee reports states or suggests that incidental interests such as the assignment provision at issue here have to be disclosed as security interests under the original Act. The Senate Report on the Simplification Act states quite clearly that such incidental interests are *not* security interests. (Ford Br. 20). Indeed, this distinction was so obvious to the drafters of the Simplification Act (as it must have been to the drafters of the original Act) that they felt it unnecessary to express it in the text of the statute itself, which merely continues the requirement of the present Act that "security interests" must be disclosed. *See* Section 614(a)(9) of the Simplification Act, 94 Stat. 179.

This Court has repeatedly looked to the views of a subsequent Congress to shed light on the intent of the enacting

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[11] As a member of the Senate Committee on Banking, Housing and Urban Affairs and of the Conference Committee which reported the bill which became the Simplification Act, Senator Garn was in an excellent position to assess how the Simplification Act would affect the original Act. This Court in *Milhollin, supra,* 444 U.S. at 567, cited approvingly the remarks of Senator Garn in the Congressional Record with respect to an earlier amendment to the Act. The fact that Senator Garn did not dissent from the Senate Report or the Conference Report suggests that he regarded those reports as being entirely consistent with his strongly-expressed views that certain courts had misinterpreted the Act regarding security interest disclosure.

one. (Ford Br. 22). Ford Credit's interpretation of the relevance of the Simplification Act to the original Act is supported by (1) Senator Garn's statement, (2) the Board's analysis of the Simplification Act, and (3) the Senate Report's distinction between security interests which have to be disclosed and "incidental interests" not requiring disclosure (such as the assignment of unearned insurance premiums). When these factors are considered in conjunction with the purpose of the original Act and the legislative history of the security interest disclosure provision, the inescapable conclusion is that Congress never intended to require disclosure of the assignment provision.

II. THE FEDERAL RESERVE BOARD DOES NOT REQUIRE DISCLOSURE OF THE ASSIGNMENT PROVISION UNDER THE PRESENT ACT AND REGULATION.

In patently inconsistent fashion, Respondents both claim the support of an inapposite early informal interpretation by the staff of the Board,[12] while completely rejecting the authoritative interpretation of the Board's staff contained in proposed Official Staff Interpretation FC-0173 (hereinafter "FC-0173") (Ford Br. Add. 54-57) which is, without question, directly on point. Respondents contend that this Court should not look to FC-0173 because the staff expressed the view that "in light of the Supreme Court's

[12] FRB Public Information Letter No. 377, a 1970 informal staff interpretation relied upon by Respondents as being entitled to "substantial deference" (Resp. Br. 16-17), is entirely distinguishable from the instant case. It involved the financing of a single premium lifetime accidental death and dismemberment insurance policy in which the lender was designated as the owner of the policy during the life of the loan and had the right to apply any premium refund to the loan balance in the event of default. Such interest was not merely incidental or subordinate to some far more significant interest securing payment of the loan.

grant of certiorari [in this case] . . . the staff believes it is inappropriate to take final action on the interpretation at this time." (Ford Br. Add. 58). A letter dated January 23, 1981 from Paul A. Volcker, Chairman of the Board, to AVCO Financial Services, a copy of which is attached hereto as Appendix A, confirms that the sole reason for the deferral of final action on FC-0173 was "because the Supreme Court has agreed to hear a case involving the issue. We simply believe it is more appropriate for us to allow the Court the opportunity to decide the question." The Board's willingness to defer final action on FC-0173 indicates respect for the authority of this Court by an agency which has traditionally shown a reluctance to provide opinions on issues which are in the courts. (Ford Br. 34). Such deference does not represent any retreat from the views expressed in FC-0173.[13]

Respondents also contend that the staff's procedure in proposing FC-0173 for comment before final adoption purportedly demonstrates its tentative nature. (Resp. Br. 30). In fact, however, the staff of the Board on other recent occasions has proposed official staff interpretations (which were later adopted) in exactly the same way. *See, e.g.*, 45 Fed. Reg. 41437 (June 19, 1980) (proposing FC-0172) and 45 Fed. Reg. 62976 (Sept. 23, 1980) (adopting FC-0172).

[13] Respondents attack the motives of the Board by suggesting that it is deferring action on FC-0173 so as to give creditors "a second bite at the apple," and that Board interpretations serve only "to protect creditors from liability." (Resp. Br. 32, n.28). In another incorrect statement, Respondents assert that Ford Credit was required to pay two million dollars to customers under a FTC consent decree involving the proceeds of the sale of repossessed automobiles. (Resp. Br. 13, n.8). In fact, the FTC proceeding was aimed at controlling the repossession practices of certain automobile dealers, and the consent decree did not require Ford Credit to pay any amount to anyone. This type of argument merely reveals the poverty of the Respondents' position.

Rather than indicating any uncertainty on the part of the staff toward such proposed interpretations, including FC-0173, the procedure used of disseminating the proposed official staff interpretation for comment prior to its adoption simply provides a more expeditious method of adopting an interpretation which the Board believes will draw public comment.[14]

A memorandum supplied by the Board to the Solicitor General (which appeared as an appendix to Ford Credit's reply brief in the *Milhollin* case and is attached to this brief as Appendix B) noted that, as of November 9, 1979, all of the 167 official staff interpretations proposed under the Act had been adopted without any substantive change despite reconsideration of some interpretations following public comments. *See* A-4, *infra*. The five proposed official staff interpretations promulgated since November 9, 1979 have similarly been adopted without substantive change. Given the virtually unbroken history of adoption, without substantive change, of official staff interpretations as they were originally proposed, there is no basis whatsoever for Respondents' contention that proposed but unadopted official staff interpretations have "no meaning" and are nothing more than "lightning rods for public comment." (Resp. Br. 29).

Since FC-0173 has not yet been adopted, Ford Credit cannot rely upon it as establishing a complete defense under 15 U.S.C. § 1640(f). The Board was obviously referring to such defense when it stated in the mailing cited by Re-

[14] The alternative procedure requires the following steps: (1) publication of a proposed interpretation without requesting comments; (2) suspension of the interpretation when a request for comment is received; (3) republication of the interpretation with the public expressly invited to comment; and (4) adoption of the interpretation. 12 C.F.R. § 226.1(d)(2).

spondents that FC-0173 "may not be relied upon until final action is taken." (Resp. Br. Add. 3). However, a proposed agency interpretation such as FC-0173 is entitled to such persuasive weight as is evident from the thoroughness of its consideration, the validity of its reasoning, and its consistency with earlier and later pronouncements. *GTE Sylvania* v. *Consumer Product Safety Commission,* 598 F.2d 790, 801-802 (3d Cir. 1979), *aff'd,* 447 U.S. 102 (1980), *citing Skidmore* v. *Swift & Co.,* 323 U.S. 134, 140 (1944); *see also United States* v. *Exxon Corp.,* 87 F.R.D. 624, 630-33 (D.D.C. 1980); *Harris* v. *Brown,* 470 F. Supp. 250, 253 (W.D. Mo. 1979). In considering and drafting FC-0173, the Board's staff had the benefit of the Congressional hearings which led to adoption of the Simplification Act, the Board's on-going revision of Regulation Z and the numerous judicial decisions on this issue. FC-0173 is thus entitled to great weight as reflecting the staff's considered judgment that the assignment provision need not be included in the disclosure statement.

III. A DECISION BY THIS COURT REQUIRING DISCLOSURE OF THE ASSIGNMENT PROVISION SHOULD BE GIVEN ONLY PROSPECTIVE APPLICATION.

Lenders throughout the nation, acting in good faith to comply with the Act, have not regarded the assignment provision at issue here as a "security interest" required to be disclosed as such under the Act.[15] Substantial injustice

[15] Although Respondents cite one isolated example of a lender who disclosed an interest in insurance premium refunds as a security interest (Resp. Br. 39), the Industry *Amici* demonstrate that the uniform practice of the credit industry has been not to treat such interests as "security interests". (Industry Br. 8, n.13). *See also* Edmonds and Taylor, *Truth and Consequences,* 35 Wash. & Lee L. Rev. 367, 388-89 (1978).

would result if a ruling requiring disclosure of the assignment provision, which was not clearly foreshadowed, were applied retroactively to the millions of outstanding contracts which contain such provisions on their reverse sides. Therefore, under the guidelines set forth in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), Ford Credit urges that any such ruling be made prospective only.

Respondents contend that this Court should not grant prospective relief in this case because (a) no case or controversy is presented (Resp. Br. 32-34) and (b) the Act preempts the *Chevron* doctrine (Resp. Br. 35-37). Neither contention is valid. Respondents' professed concern that there is no "adversary relationship" on this issue is belied by the vigorous confrontation of opposing views expressed in the briefs filed herein. Since the Court has power to grant relief prospectively except for Respondents, *Stovall* v. *Denno*, 388 U.S. 293, 301 (1967), surely Ford Credit is entitled to ask the Court to exercise such power in this case. Otherwise, the Court would be deprived of the effective advocacy the "case or controversy" rule serves to promote.

Respondents' argument that the Act preempts the equitable doctrine of prospective relief is equally specious. No court has held that the Act preempts the doctrine of prospective relief or that prospective relief can never be proper in a Truth in Lending suit. Indeed, as noted in our initial brief, prospective relief has been granted in several cases under the Act in order to avoid unfairly harsh impacts on lenders. (Ford Br. 43-44). Respondents repeatedly assert that prospective relief is inappropriate because of the one year statute of limitations under the Act. (Resp. Br. 35, 38, 44). However, in most states, including Illinois, debtors are permitted to assert counterclaims or setoffs based on the Act despite the expiration of the one-year

limitations period.[16] Thus, retroactive application of an adverse decision on this issue would expose lenders to liability in connection with all outstanding credit transactions, even those entered into several years ago.

During the first seven years that the Act was in force, there were no reported decisions dealing with this issue. Accordingly, Respondents' suggestion that the credit industry could have requested an opinion from the Board to resolve this issue without litigation (Resp. Br. 43, n.40) is disingenuous. Prior to the onset of litigation, the credit industry had no inkling that this issue existed. After the litigation commenced, it was difficult to obtain an interpretation from the Board because of its long-standing reluctance to become involved in pending private litigation. (Ford Br. 34).

Application of the *Chevron* guidelines requires a weighing of the equities. On the one hand, consumers are not injured in any way by virtue of the placement of the assignment provision on the back rather than the front of credit contracts. Although actual damages are permitted for violations of the Act, 15 U.S.C. § 1640(a)(1), this provision is very rarely used since such damages are virtually never incurred. The Respondents themselves have not sought to recover any actual damages. (J.A. 4). On the other hand, creditors have gained no economic benefit from having the assignment provision on the back of the contract, as opposed to the front. It would be fundamentally unfair to impose potentially enormous penalties on the consumer credit industry for what is, at worst, a purely technical violation of the Act.

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[16] Cases in which state courts have held that a Truth in Lending Act counterclaim may be asserted after the one year statute of limitations period are compiled in *Plant* v. *Blazer Financial Services, Inc.*, 598 F.2d 1357, 1364 n.13 (5th Cir. 1979).

Respondents attempt to belittle the losses which the credit industry would incur from retroactive application of an adverse decision by comparing Ford Credit's potential liability from the lawsuits *now* pending against it with Ford Credit's total assets. (Resp. Br. 45-46). Such comparison is totally misleading. It can be expected that the number of suits and counterclaims alleging a violation of the Act will increase dramatically if this case is decided adversely to Ford Credit. Contrary to Respondents' characterization, the credit industry does not regard the costs of such litigation (including statutory damages, court costs and attorneys' fees) as "paltry". (Resp. Br. 46; *cf.* Industry Br. 6-7).[17]

Finally, Respondents seek to bar Ford Credit from receiving equitable relief on the theory that it took a "conscious gamble" in not changing its contract form nationwide immediately following the Fifth Circuit's decision in *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). (Resp. Br. 43). Yet, that argument would require credit industry forms to be rewritten at the slightest shifts in judicial currents in this complex and ever-changing area—a process very expensive to the industry and ultimately to the consumer. (Industry Br. 5-6). In light of the purposes of the Act, its legislative history, applicable interpretations of the Board, and the custom and usage in the credit industry, Ford Credit has more than reasonable grounds for believing that its position on the merits of this issue is correct and for refraining from modifying its nationwide contract form pending a more authoritative judicial de-

[17] The credit industry as a whole, and Ford Credit in particular, are not so strong financially as to be able to absorb such massive costs easily. Ford Credit, for example, is a wholly-owned subsidiary of Ford Motor Company, which lost over $1.5 *billion* in fiscal 1980. The Wall Street Journal, Feb. 20, 1981, at 4, col. 1.

termination of this issue. Thus, even if this Court were to disagree with Ford Credit's position on the merits, a prospective-only ruling would be appropriate under all of the circumstances of this case.

CONCLUSION

For the reasons stated above, Petitioners respectfully request the Court to reverse the judgment of the Court of Appeals below.

Respectfully submitted,

AARON J. KRAMER
7200 Sears Tower
233 South Wacker Drive
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Appendices

APPENDIX A

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

January 23, 1981

RECEIVED
JAN 29 1981
LEGAL DIVISION

Mr. Charles Krugmeier
Assistant Vice President
and Counsel
AVCO Financial Services
620 Newport Center Drive
Newport Beach, California 92660

Dear Mr. Krugmeier:

I have read your letter asking the Board to issue an interpretation of Regulation Z on credit life insurance. As you know, we proposed to take the position you favor, but have delayed final action on the interpretation because the Supreme Court has agreed to hear a case involving the issue. We simply believe it is more appropriate for us to allow the Court the opportunity to decide the question.

I appreciate your point that property and credit life are two different types of insurance. However, while the distinctions you draw are valid, our view is that property and credit life insurance involve the same basic issue for purposes of Truth in Lending.

As you probably know, under the Truth in Lending Simplification and Reform Act, the whole issue about disclosing these insurance refunds and benefits disappears. It's clear in both the statute and the proposed regulation that no disclosure will be required in the future. Although not an immediate solution, at least the problem you are concerned about won't persist forever.

Sincerely,

Paul A. Volcker

APPENDIX B

Memorandum.

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM

Date November 9, 1979
Office Correspondence
To Neil Butler and
Dolores S. Smith
From Lynne B. Barr
Subject: Issuance of Official
Staff Interpretations

As requested by the Justice Department, this memorandum is a brief summary of internal procedures employed by the Division of Consumer and Community Affairs from 1976 to the present with respect to official staff interpretations (OSIs) of Regulations B and Z. Many of these procedures were not changed when procedures for delayed effective dates and comment periods were adopted in 1978, and you can assume they are still in place unless I indicate otherwise.

It should be noted that the statutory provisions in question permit the Board to authorize any "official or employee of the Federal Reserve System" to issue interpretations or approvals under the regulations. One alternative available to the Board in 1976 was to authorize non-official staff members of the Board or other officials or employees of the System (such as Federal Reserve Bank personnel) to issue the interpretations. That course was not recommended by the staff to the Board because we felt that the interpretations should be uniform and should involve a relatively high level of review.

When the Board considered the designation of officials several Board members expressed concern about control and review of the interpretations. For that reason, a number of procedures were adopted by the Board. The first is the mandatory review of all OSIs by two officials of the Division. Each OSI is reviewed and initialed by one official before it is reviewed and signed by the official whose signature the letter bears.

Second, the Board decided that all OSIs would be reviewed quarterly by the Consumer Affairs Committee (the committee of Board members with oversight responsibility over the Division of Consumer and Community Affairs). At the time FC-0054 was issued, the Committee members reviewed the letters themselves. They now receive a summary of the letters.

Third, written internal procedures for preparation and issuance of the OSIs and unofficial interpretations were developed and circulated to all staff members. A copy of these procedures is attached.

The letters were and continue to be prepared in the following way. A request for an OSI is acknowledged and then assigned to a staff attorney for response. If the request appears incomplete or relevant documents were not included in the original request, the attorney will ask the requesting party for further information. A draft response to the letter is prepared, usually in consultation with other staff attorneys, section chiefs, and officials. An initial determination is made at that time whether or not the response should be official. This draft is often reviewed and discussed in group meetings with officials, section chiefs, and staff attorneys familiar with the subject matter. The letter is then issued after further review by the staff attorney's section chief and two officials.

As you know, OSIs were originally effective upon publication in the *Federal Register*, with provision for reconsideration upon request. One hundred forty-seven OSIs under Regulation Z and 10 under Regulation B were issued under this procedure. Of the Regulation Z OSIs issued between August 1976 and April 1978, approximately 6 were reconsidered, either by the Consumer Affairs Committee or the Board. None were changed.

In April 1978, the Board amended the procedures to provide a delayed effective date and a period for public comment if reconsideration of an OSI was requested. Of the 20 OSIs of Regulation Z issued since April 1978, 9 have been reconsidered; none were substantively changed as a result of the reconsideration and public comments.

Attachment
cc: Janet Hart

PROCEDURES FOR ISSUANCE OF INTERPRETATIONS OF REGULATIONS Z AND B

FAIR CREDIT PRACTICES SECTION
EQUAL CREDIT OPPORTUNITY SECTION

The purpose of this memorandum is to describe the procedures to be employed by staff of the Fair Credit Practices and Equal Credit Opportunity sections of OSCA in processing requests for Board interpretations and official staff interpretations of Regulations Z and B, and for issuance of unofficial staff opinion letters on those Regulations. Under these procedures, which are set forth in § 202.13(b) and (c) of Regulation B and § 226.1(c) and (d) of Regulation Z, there will be three kinds of interpretations of Regulations Z and B: (1) official Board interpretations, (2) official staff interpretations, and (3) unofficial staff interpretations. The procedures become effective July 30, 1976. A copy of the amendments to the Regulations is attached.

I. *Types of Interpretations*

1. *Formal Board interpretations* will continue to be issued only in response to those requests which involve "potentially controversial issues of general applicability which concern substantial ambiguities in the Regulations and raise significant policy questions." Board interpretations are published in the *Federal Register.*

2. *Official staff interpretations* will be issued in response to those requests which, in the opinion of one or more officers of OSCA, require clarification of technical ambiguities in the Regulation or which

have no significant policy implications. The official staff interpretations will be published in the *Federal Register*, with identifying details deleted. See Attachment A for examples.

3. *Unofficial staff interpretations* will be issued where the person making the request does not require the protection of the Act, where the issue is minor or has already been satisfactorily resolved, or where time strictures mandate a rapid response. These letters are not published in the *Federal Register* but may become part of the Board's Public Information file, depending on the significance of the opinion expressed therein. See Attachment B for examples.

II. *Processing of Requests*

Requests for interpretations of the Regulations will normally be addressed to the Director of OSCA. Letters addressed to other officials or employees of the Board, however, will also be considered as formal requests (if the nature of the request so indicates) and the same requirements will apply. All requests received in OSCA will be logged in, routed through the section chiefs of FCP and ECOA and assigned to individual staff members.

The assigned staff member will examine the request to determine that it contains a complete statement of all relevant facts, that all pertinent documents are included and properly incorporated and that the request states the specific provisions of the statute and Regulation which are at issue. If the request for interpretation is incomplete the staff member should either (1) acknowledge the request by mail and ask for more information, or (2) request the additional information by telephone. If by telephone, the person making the

request for interpretation should be asked to supply a copy of such additional information by mail in order to compile a complete written record of the relevant facts. It should be noted that while certain requirements for requests for interpretations are set forth in the Regulations (§ 226.1(d)(1) and § 202.13(c)(1)), these requirements are not inflexible and noncompliance with them should not be used to delay a request if the statement contained in the request is complete.

If the request for interpretation is complete (or upon receipt of the requested additional information), the staff member has five working days within which to make a recommendation to the section chief as to what type of response should be given. An initial determination as to the proper response will be made by the staff member and the section chief at that time. Within 15 days of the *receipt of the complete request by OSCA*, a substantive response will be sent to the person making the request or an acknowledgement will be sent which sets a reasonable time within which a substantive response will be given. Except in the most unusual cases. sixty days from the time a request is complete should be a sufficient amount of time in which to answer a request.

A discussion of the different types of interpretations, the criteria to be used in issuing such interpretations and varying procedures for their issuance is set forth below.

1. *Official Board interpretations* are formal interpretations of regulations issued only by the Board of Governors. They will be issued only upon those requests which involve "potentially controversial issues of general applicability which concern substantial ambiguities in the Regulations and raise significant policy questions."

When a determination is made by the staff member and section chief that a particular request poses issues of such significance that a formal Board interpretation may be desirable, the OSCA officials should be apprised of the issues. If the officials decide to recommend to the Governors' Committee that such an interpretation be issued by the Board, a draft Board memorandum should be prepared. The memorandum should state the issue involved and the reasons why the present status of the Regulation is inadequate to resolve the issue, and should suggest an approach to be taken in an official Board interpretation. This memorandum need not be accompanied by draft *Federal Register* material. If the Governors' Committee determines that an interpretation is necessary, the Board memorandum and *Federal Register* material will be prepared.

All official Board interpretations, except those which clearly deal with noncontroversial or technical issues, will be published for comment in the *Federal Register* before being issued in final form. See Attachment C for an example.

The *Federal Register* material for such interpretations should contain a docket number (issued by the Secretary's Office), a discussion of the substance of the interpretation and a statement that the interpretation is being issued for comment by the Board in order to assure an informed decision-making process. The comment period will be 30 days. The interpretation will become effective 60 days after issuance for comment (30 days after the close of the comment period) without further action by the Board, unless significant comments have been received. If such comments have been received, the section staff and OSCA officials will make recommendations to the OSCA Governors' Committee as to what changes, if any, should be made.

If the interpretation remains unchanged a *Federal Register* notice should be published, before the original effective date, which discusses the comments and states the Board's reasons for issuing the interpretation in final form as it was originally proposed. This notice would require Board action, usually on the consent calendar.

If the comments indicate and OSCA staff agree that the interpretation should be changed, a Board memorandum and *Federal Register* material outlining the changes and the reasons therefor should be prepared in advance of the original effective date and submitted through the OSCA Governors' Committee to the Board for approval. If the Board cannot act on the proposal before the original effective date, a notice postponing the effective date until further notice should be published in the Register (see p. 43 of FR *Document Drafting Handbook* for example). The interpretation will then be issued in final form in the *Register*. In most cases, the effective date should be delayed 30 days, but the delay can be waived in certain cases (5 U.S.C. § 553(d)).

2. Official staff interpretations will be issued in response to requests which require clarification of technical ambiguities in the Regulation or which have no significant policy implications. They are expected to be the bulk of the responses made by OSCA to requests for interpretation, and will generally cover, with some restriction, the same range of issues as the present Public Information Letters. They will be published in the *Federal Register*, with identifying details deleted, although such identification can be obtained through the Board's Public Information Office.

The staff member to whom the request has been assigned will decide, in conjunction with the Section

Chief, if the request should be answered with an official staff interpretation. If so, the letter will be drafted. Each letter should contain a complete recitation of the facts as they were presented in the request, and a statement that the response is based on only those facts. The letter should be approved by section level personnel and forwarded to (1) a designated official of OSCA who will approve and *initial* the interpretation, *and* (2) to the designated official who will both sign the letter and initial it. Each letter will be initialed by two OSCA officials.

Every official staff interpretation must contain the following statement denoting its status:

> This letter is an official staff interpretation of Regulation B(Z), issued, in accordance with § 202.13(c)(3) (§ 226.1(d)(3)) of the Regulation.

In most cases, the letter will be sent after it is signed to the person making the request, and a copy will be sent to the *Federal Register* for publication. The *Federal Register* material should be prepared as a rules document (see p. 12 of *Document Drafting Handbook* and Attachment C for an example), but without an explanatory preamble or a docket number (except when issued for comment). Each letter should have a short explanatory headnote (no more than two sentences).

Staff is encouraged to publish two or more staff interpretations within the same notice to avoid duplication of resources. The effective date does not need to be delayed as these interpretations are subject to the exception in 5 U.S.C. § 553(d) for interpretative rules. Staff interpretations should be numbered consecutively in the following manner: *Regulation B—12 CFR*

Part 202, EC-0001; Regulation Z—12 CFR Part 226, FC-0001.

Certain official staff interpretations will be published for comment prior to their effective date. When a request for interpretation poses a novel or controversial question which is not of sufficient importance to warrant a Board interpretation but would be subject to differing views by interested parties, the interpretation should be published for comment in the *Register*. The inquiring party should be notified that the interpretation is being published for comment before being issued in final form. The procedures to be followed for such publication are identical to those used for official Board interpretations (see page 4), except that the staff interpretation will be written as a letter response to a request and will be approved by two OSCA officials. Comments received on the proposal will be reviewed by staff, and OSCA officials will approve the final form of the interpretation.

The OSCA Governors' Committee will review all official staff interpretations on a quarterly basis and each section chief will be responsible for providing the Director of OSCA with a complete reading file of official staff interpretations, normally within 15 days after the end of the quarter.

3. *Unofficial staff interpretations* will be issued by OSCA staff in those cases where the protection of the Act is neither requested nor required or where a speedy response is required. These letters will usually be issued in the following cases:

1. The question has been satisfactorily answered in the past by an official letter or by a Public Information Letter, which has not been given

official status and which does not warrant such status.

2. The request involves narrow issues that do not affect a significant number of creditors.
3. The person making the request requires a rapid response.
4. The person making the request does not seek the Act's protection.
5. The request for official staff (or Board) interpretation is answered in the negative.

The staff member, in conjunction with the section chief, will determine that a request should be answered with an unofficial interpretation. The letter will be drafted, approved and signed by the section chief or the staff member. Each letter which responds to a request for an official interpretation should contain an explanation of the reasons why an unofficial interpretation has been issued instead. Generally, the reasons for denial can be couched in the language of the Regulation (see § 202.13(c)(4) and § 226.1(d)(4)).

Every unofficial staff interpretation must contain the following statement denoting its status:

> This is an unofficial staff interpretation of Regulation B(Z).

Unofficial interpretations will be sent to the person making the request and will, if the material contained in the letter is of sufficient interest, become part of the Public Information file.

4. *Reconsideration of official staff interpretations* by the Board may occur upon request of interested parties. Requests for reconsideration must be made

within 30 days of final publication in the *Register* and will be addressed to the Secretary of the Board. The request for reconsideration must be granted or denied within 15 days of receipt or an acknowledgement sent which sets a reasonable time within which a response will be given. OSCA staff of the relevant section and officials will study the request and make an independent recommendation to the OSCA Governor's Committee. The person who made the original request for interpretation, if different from the person requesting reconsideration, should be contacted informally concerning the request for reconsideration, and an opportunity given to that person to comment upon it prior to the Committee's decision. The Committee will decide whether or not to grant the request for reconsideration.

If the request is denied, a response, signed by the Secretary and drafted by OSCA staff, which states the reasons for the denial, will be sent to the person making the request.

If the request for reconsideration by the Board is granted, staff will prepare a Board memorandum. If the Board determines that the staff interpretation should remain unchanged, the person making the request will be so notified by a letter from the Secretary which has been drafted by OSCA staff. If a decision is made by the Board that the interpretation should be changed, the new interpretation will be drafted by OSCA staff, signed and initialed by OSCA officials and should be published in the *Federal Register*, with a notice which rescinds the previously issued interpretation. The person who made the original request for interpretation should be notified by OSCA officials of the action taken.

APPENDIX C

Subsidiaries of Ford Motor Company.

DOMESTIC AFFILIATES

Ford Credit — Canada Limited
Ford Motor Credit Company International
The American Road Insurance Company
Ford Life Insurance Company
Vista Insurance Company
Vista Life Insurance Company
American Road Services Company
American Road Equity Corporation
Ford Consumer Credit Company
Ford Motor Credit Company of Iowa
Ford Consumer Discount Company
Philco Finance Corporation
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Ford Credit Equity Corporation
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Eveleth Taconite Company (Delaware)
Ford Products Company (Delaware)
Ford Communications, Inc. (Delaware)
Environ Inc. (Delaware)
Ohio Production Corporation (Delaware)
Predelivery Service Corporation (Delaware)
Ford Export Corporation (Delaware)
Ford Motor Land Development Corporation (Delaware)
Detroit Downtown Development Corporation (Delaware)
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Greenfield Properties, Inc. (Delaware)
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Rise Services Incorporated (Delaware)
Dearborn Capital Corporation (Delaware)
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No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Petitioners,

v.

OLGA VALENCIA AND MIGUEL GONZALEZ,

Respondents.

On A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF OF THE CONSUMER BANKERS ASSOCIATION, GENERAL MOTORS ACCEPTANCE CORPORATION AND THE NATIONAL CONSUMER FINANCE ASSOCIATION AS *AMICI CURIAE*

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TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES iii

INTEREST OF *Amici Curiae* 1

SUMMARY OF ARGUMENT 3

ARGUMENT 4

I. INTRODUCTION 4

II. BY ATTEMPTING TO DEVISE A FEDERAL COMMON LAW OF SECURITY INTERESTS, THE COURT BELOW IMPROPERLY CREATED A DISCLOSURE REQUIREMENT NOT FOUND IN TILA, IN DIRECT CONTRAVENTION OF AUTHORITATIVE PRONOUNCEMENTS OF THE FEDERAL RESERVE BOARD 9

A. Neither The "Express Language" Of TILA Nor That Of The Implementing Regulation Requires The Disclosure Of The Disposition Of Unearned Insurance Premiums As A Security Interest 9

B. The Federal Reserve Board Concluded That State Law Determined What Constituted A "Security Interest" Under TILA. The District Court Held That, Applying Only State Law, There Was No Security Interest 12

1. The Decision Below Is Contrary To This Court's Decision In *Milhollin*, Which Recognized The Federal Reserve Board And Its Staff As The Authoritative Interpretive Source In Identifying TILA Disclosure Requirements 13

2. In Unofficial Staff Interpretations The Federal Reserve Board Ruled That State Law Governs Whether A Security Interest Exists For TILA Disclosure Purposes 16

Table of Contents Continued

PAGE

3. The District Court Found That, Under State Law, No Security Interest Existed. *A Fortiori*, No Disclosure Is Required 20

III. IF THE PRACTICE FOLLOWED BY PETITIONERS IS FOUND TO BE A VIOLATION OF TILA, THE DISCLOSURE REQUIREMENT INVOLVED SHOULD BE PROSPECTIVE ONLY 21

A. The Analysis Of *Chevron* By The Court Below Was Incorrect 21

B. Under Established Principles Of Judicial Discretion Extending Beyond *Chevron*, A Decision Requiring Disclosure Should Be Prospective Only 23

1. A Retrospective Disclosure Requirement Would Not Promote TILA Purposes As Identified By Congress 24

2. Retrospective Application Of A Disclosure Requirement Has A Punitive Effect On Creditors And Gives A Windfall To Litigating Debtors 27

3. A Minimum Ninety-Day Delay In The Effect Of A Final Appellate Decision Reflecting A New Disclosure Requirement Is Both Necessary And Appropriate 28

CONCLUSION 30

TABLE OF AUTHORITIES

CASES: PAGE

Almeida-Sanchez v. *United States*, 413 U.S. 266 (1973) .. 24

Anthony v. *Community Loan and Investment Co.*, 559 F.2d 1363, *reh. en banc denied*, 564 F.2d 416 (5th Cir. 1977) 10

Automatic Radio Manufacturing Co. v. *Hazeltine Research, Inc.*, 399 U.S. 827 (1950) 27

Bendix Corporation v. *Balax, Inc.*, 471 F.2d 149 (7th Cir. 1972), *cert. denied*, 414 U.S. 819 (1973) 27

Bowles v. *Seminole Rock and Sand Co.*, 325 U.S. 410 (1945) 13

Brown v. *Termplan, Inc.*, 459 F.Supp. 160 (N.D. Ga. 1978) 26

Bruton v. *United States*, 391 U.S. 123 (1968)..... 25

Bulger v. *Thorp Credit Inc.*, 609 F.2d 1255 (7th Cir. 1979) 20

Butner v. *United States*, 440 U.S. 48 (1979)..... 19

Chevron Oil Co. v. *Huson*, 404 U.S. 97 (1971) 21, 22, 23, 25

Elzea v. *National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978) 19

Edmondson v. *Allen-Russell Ford, Inc.*, Civ. No. C75-940A (N.D. Ga. 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979)..... 19, 20, 21, 22

Ford Motor Credit Co. v. *Milhollin*, 444 U.S. 555 (1980)..... 10, 11, 12, 13, 14, 15, 16, 20, 21

Fuentes v. *Shevin*, 407 U.S. 67 (1972) 23

Gennuso v. *Commercial Bank & Trust Co.*, 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd*, 566 F.2d 437 (3rd Cir. 1977)..... 20, 22

Goldberg v. *Kelly*, 397 U.S. 254 (1970)..... 23

Table of Authorities Continued

CASES:	PAGE
Grant v. *Imperial Motors*, 539 F.2d 506 (5th Cir. 1976)	7
James v. *Ford Motor Credit Co.*, Civ. No. 78-1806 (10th Cir. June 24, 1980), *reh. denied* (10th Cir. July 21, 1980)	8, 27
Kacher v. *Pittsburgh National Bank*, 545 F.2d 842 (3rd Cir. 1976)	23
Lauletta v. *Valley Buick, Inc.*, 421 F.Supp. 1036 (W.D. Pa. 1976)	5
Lear, Inc. v. *Adkins*, 395 U.S. 653 (1969)	27, 28
Linkletter v. *Walker*, 381 U.S. 618 (1965)	24
Lyons v. *Westinghouse Electric Corporation*, 235 F.Supp. 526 (S.D. N.Y. 1964)	28
Mapp v. *Ohio*, 367 U.S. 643 (1961)	24
McDaniel v. *Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978)	29
Mirabal v. *General Motors Acceptance Corp.*, 537 F.2d 871 (7th Cir. 1976)	26
Mourning v. *Family Publications Service, Inc.*, 411 U.S. 356 (1973)	14
Murphy v. *Ford Motor Credit Co.*, 629 F.2d 556 (8th Cir. 1980)	20
Plant v. *Blazer Financial Services, Inc.*, 598 F.2d 1357 (5th Cir. 1979)	8
Power Reactor Development Co. v. *Electrical Workers*, 367 U.S. 396 (1961)	13
Roberts v. *Russell*, 392 U.S. 293, *reh. denied*, 393 U.S. 899 (1968)	25
Rounds v. *Community National Bank in Monmouth*, 454 F.Supp. 883 (S.D. Ill. 1978)	10

Table of Authorities Continued

CASES: PAGE

Shanks v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978) 19, 21, 22

Simpson v. *Union Oil Company*, 377 U.S. 13 (1964) 28

Sniadach v. *Family Finance Corp.*, 395 U.S. 337 (1969) . 23

Souife v. *First National Bank of Commerce*, 628 F.2d 480 (5th Cir. 1980) 16

St. Germain v. *Bank of Hawaii*, 573 F.2d 572 (9th Cir. 1977) 11

Stovall v. *Denno*, 388 U.S. 293 (1967) 24, 25

Travis v. *Trust Company Bank*, 621 F.2d 148 (5th Cir. 1980) 26

Udall v. *Tallman*, 380 U.S. 1 (1965) 13

United States v. *Miller*, 492 F.2d 37 (5th Cir. 1974), *cert. denied*, 422 U.S. 1056 (1975)..... 25

United States v. *Peltier*, 422 U.S. 531 (1975) 24

Young, Ex parte, 209 U.S. 123 (1908)..... 28

Zenith Radio Corp. v. *United States*, 437 U.S. 443 (1978) 13

STATUTES:

Truth in Lending Act, Pub. L. No. 90-321, Title I, 82 Stat. 146 (1968), as amended, 15 U.S.C. §1601 *et seq.* ..... *passim*

15 U.S.C. §1601 ..... 4, 26

15 U.S.C. §1604..... 29

15 U.S.C. §1614..... 6

15 U.S.C. §1638(a)(10) 9

15 U.S.C. §1639(a)(8) 9

15 U.S.C. §1640(a)(1) 6, 26

Table of Authorities Continued

STATUTES: PAGE

15 U.S.C. §1640(a)(2)(A) 6

15 U.S.C. §1640(a)(2)(B) 7

15 U.S.C. §1640(a)(3) 7

15 U.S.C. §1640(e) 8

15 U.S.C. §1640(f) 15

Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, Title VI, 94 Stat. 168 (amending 15 U.S.C. §1601 *et seq.*) 10, 29

Section 605 of the Truth in Lending Simplification and Reform Act (amending 15 U.S.C. §1604) 29

REGULATIONS:

Regulation Z, 12 C.F.R. Part 226 (1980) ..... *passim*

12 C.F.R. §226.1(d) 14

12 C.F.R. §226.2(gg) 9

12 C.F.R. §226.6(c) 5

12 C.F.R. §226.8(a) 5

12 C.F.R. §226.8(b)(4) 15

12 C.F.R. §226.8(b)(5) 9

12 C.F.R. §226.8(b)(7) 15

MISCELLANEOUS:

1975 *Annual Report of the Director,* Administrative Office of the United States Courts 7

1980 *Annual Report of the Director,* Administrative Office of the United States Courts 7

Brief In Opposition To Petition For A Writ Of Certiorari 8

Table of Authorities Continued

MISCELLANEOUS: PAGE

Brief Of The Consumer Bankers Association As Amicus Curiae, Ford Motor Credit Corp. v. *Milhollin*, 444 U.S. 555 (1980)(No.78-1487) 11

1 *Cons. Cred. Guide (CCH)* ¶ 1005 17

125 *Cong. Rec.* S4990, 96th Cong., 1st Sess. (1979) 10

FRB Public Information Letter No. 114, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,159 (September 30, 1969) 16, 17

FRB Public Information Letter No. 130, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,478 (October 7, 1969) 5

FRB Public Information Letter No. 132, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,479 (October 7, 1969) 5

FRB Public Information Letter No. 150, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,492 (October 14, 1969) 5

FRB Public Information Letter No. 377, [1969-1974 Transfer Binder] *Cons. Cred Guide (CCH)* ¶ 30,555 (July 22, 1970) 18

FRB Public Information Letter No. 829, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,151 (August 22, 1974) 16

FRB Public Information Letter No. 1053, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,393 (May 28, 1976) 17

FRB Public Information Letter No. 1080, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,420 (July 14, 1976) 17

FRB Public Information Letter No. 1125, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,475 (November 2, 1976) 17

FRB Public Information Letter No. 1145, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,520 (January 11, 1977) 17

Table of Authorities Continued

MISCELLANEOUS: PAGE

FRB Public Information Letter No. 1151, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,531 (January 31, 1977) 17

FRB Public Information Letter No. 1227, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,666 (July 29, 1977) 17

FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,736 (November 23, 1977) 17, 18

3 *Moore's Federal Practice* ¶ 13.11 (2d. ed. 1980)..... 8

Official Staff Interpretation No. FC-0173 (Proposed), 45 *Fed. Reg.* 63295, 45 *Fed. Reg.* 84074 (1980)..... 12, 14

Petition For A Writ Of Certiorari 5, 8

Rule 36.2, Rules of the Supreme Court of the United States (1980) 1

S. Rep. No. 96-73, 96th Cong., 1st Sess. (1979) 13, 29

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BRIEF OF THE CONSUMER BANKERS ASSOCIATION, GENERAL MOTORS ACCEPTANCE CORPORATION AND THE NATIONAL CONSUMER FINANCE ASSOCIATION AS *AMICI CURIAE*

The Consumer Bankers Association, General Motors Acceptance Corporation and the National Consumer Finance Association (collectively "*Amici*") respectfully submit this Brief as *amici curiae* in support of the Petitioners, filed upon the written consent of all parties in accordance with Rule 36.2 of the Rules of this Court.

INTEREST OF *AMICI CURIAE*

The Consumer Bankers Association ("CBA"), a non-profit organization organized in 1919, provides a voice for the consumer banking industry. The membership of CBA has

grown to more than 340 commercial banks, each actively engaged in extending consumer credit. Its members hold obligations representing over $72 billion of consumer credit, more than 55 percent of all consumer credit extended by commercial banks.

General Motors Acceptance Corporation ("GMAC") is a credit finance institution that purchases retail installment contracts from automobile dealers. It has 352 branch offices in the United States and Canada, from which it provides financing services to over 18,200 General Motors dealers. GMAC holds more than 4,000,000 retail installment contracts, representing over $21 billion in outstanding credit.

The National Consumer Finance Association ("NCFA") is the nation's largest trade association serving the consumer finance industry. Founded in 1916, it represents nearly 800 consumer finance and industrial banking companies operating more than 17,000 offices across the United States. Its members hold about 90 percent of the $70 billion in outstanding consumer credit of the industry.

GMAC and the members of CBA and NCFA conduct business in every state in the nation, a substantial portion of which involves making consumer loans and acquiring retail installment sales contracts that are subject to the Federal Truth in Lending Act ("TILA"). TILA requires comprehensive credit cost disclosures in connection with every consumer credit transaction. The contract before the Court, which contains a clause that is alleged to be in violation of TILA, is standard throughout the consumer finance industry. If the decision below is sustained, it will affect virtually every contract held by GMAC and the members of CBA and NCFA.

The instant case merely illustrates the problems faced by consumer credit grantors. The proper technical disclosure of "security interests" and, specifically, unearned insurance premiums typifies the detail under TILA with which creditors must attempt to deal. *Amici* are vitally interested in having the Court reiterate the proper role of the Federal Reserve Board and thereby end the waste of judicial and economic resources caused by inconsistent judicial interpretations of hyper-technical requirements of TILA.

SUMMARY OF ARGUMENT

The issue before the Court is whether TILA requires creditors to disclose "clearly and conspicuously" as a "security interest" the assignment of returned or unearned property damage insurance premiums that relate to insurance on the collateral that secures a credit transaction.

Neither the express language of TILA nor that of implementing Regulation Z requires that this universal contract provision be disclosed as a security interest. The purpose of TILA is to assist consumers in making informed credit decisions by providing them with meaningful and comparable disclosures of *important* credit information. The decision below effectively holds that "unearned insurance premiums on property damage insurance" constitutes such critical information. That determination is not supported by TILA either literally or as intended by Congress.

Moreover, the decision under review is directly contrary to the informed judgment of the Federal Reserve Board, the agency charged with implementing and administering TILA. That judgment, reflected through Unofficial Staff Interpretations, was that *State* law decides whether a security interest exists. Here, the finding by the District Court was that there is no security interest under applicable State law. Thus, no disclosure is required.

This case involves a claimed TILA violation that plainly caused no loss or injury. If the Court determines that a violation has occurred, this case is uniquely appropriate for the exercise of judicial discretion in giving a ruling adverse to the creditor only prospective effect. TILA is not designed to provide debtors with compensation for damages suffered in consumer credit transactions, except under a rarely used provision not being invoked here. Rather, it is a statute that imposes penalties, enforced by private litigation, on creditors who do not provide with technical precision all of the disclosures ultimately held to be required. In most cases, as in this case, the debtor has not been injured by the TILA violations alleged. Equally important, consumer credit transactions

involve the use of preprinted, widely distributed forms. As a result, the cost of retooling to meet every claimed or conjured disclosure requirement is substantial, yet the potential for enormous liability in class actions is obvious if disclosure is ultimately held lacking and that decision is given retrospective effect.

Thus, by the very nature of TILA, retrospective application of a decision that is adverse to a creditor on a close question of law has the potential for punitive effects on creditors and windfall gains to debtors who are not injured in any way. It is particularly appropriate in such a case for the Court to limit its decision to prospective effect.

ARGUMENT

I. INTRODUCTION

TILA[1] was adopted to allow consumers to shop for credit on the basis of uniform, and therefore comparable, credit cost information.[2] It applies to virtually all extensions of credit for personal, family or household purposes. TILA, as implemented through Regulation Z[3] and interpretations issued by the Federal Reserve Board and its staff, applies to each of literally millions of consumer credit transactions undertaken every year.

TILA creates specific disclosure requirements that are discharged through the use of complex and often lengthy disclosure and contract forms. These forms contain both preprinted disclosure information and blanks to be filled in later to reflect dollar amounts, repayment term, and other transaction-specific information. Because of the desirability and necessity of a high-volume, low-cost credit documentation system, the need for legal review, and the potential for human errors in form completion, creditors maximize preprinted in-

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[1] Truth in Lending Act, Pub. L. No. 90-321, Title I, 82 Stat. 146 (1968), as amended, 15 U.S.C. §1601 *et seq.* (1974 & Supp. 1980).

[2] 15 U.S.C. §1601.

[3] 12 C.F.R. Part 226 (1980) (designated as "Regulation Z").

formation. As a result of these factors, lending forms are often "integrated" forms that contain both information required under TILA and contract terms and conditions that are required or permitted under State statutory or common law.[4] Importantly, most TILA cases, including this one, deal not with the question of information being made available to the consumer, but with whether the information has been disclosed in a technically precise manner, including conformity with type size and location requirements.[5]

Two basic types of credit transactions are subject to TILA, each reflected by its own type of form: (1) lending transactions in which a consumer goes directly to a creditor, executes a direct loan note, and obtains money from that creditor; and (2) retail sales in which a consumer purchases goods and services on credit from a retailer, often memorialized by retail installment sales contracts, which are normally assigned at a discount to a financing entity.

In both cases, forms are prepared either by the lender or by potential assignees of sales contracts and made available through an extensive distribution network. Often lender forms are distributed to geographically diverse branches or offices. Retail installment sales contracts incorporating required disclosures are prepared by potential contract assignees and distributed to retail sellers. These assignees provide forms to assure that the contracts they eventually hold are valid and meet all applicable Federal and State requirements. Due to the

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[4] Subject to certain limitations, additional information or explanations may be supplied with required disclosures. 12 C.F.R. §226.6(c).

[5] The disposition of unearned insurance premiums is fully described in the contract involved here in the same type size and style as the rest of the contract. *See* Illinois Automobile Retail Installment Contract dated September 30, 1977, *Petition For A Writ of Certiorari* [following A-58]. It appears, however, on the reverse side of the contract and thus, if a security interest, contravenes technical requirements mandating that prescribed disclosures appear on only one side of a page. *See* 12 C.F.R. §226.8(a); *Lauletta* v. *Valley Buick, Inc.*, 421 F.Supp. 1036, 1040 (W.D. Pa. 1976); FRB Public Information Letter Nos. 130, 132, 150, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶¶ 30,478; 30,479; 30,492 (October 7, 1969; October 7, 1969; October 14, 1969).

need for certainty,[6] assignees, with carefully scrutinized exceptions, generally will accept the assignment only of their own contracts. Thus, the retail sales community obtains forms almost exclusively from potential assignees.

Since these forms reflect both Federal and State law requirements, it is virtually always necessary to prepare forms on a State-by-State basis. Due to the combination of the number of transactions involved, the use of detailed disclosure forms, and the widespread distribution system for forms, *any* change in the law that affects a consumer credit form, including a disclosure change, triggers a substantial changeover process.[7] The extensive process involved must be undertaken with respect to *each* change in the law and *each* affected form, which in many cases may involve tens of different forms for every creditor.

It is this cumbersome machinery through which TILA requirements must be discharged and technical changes implemented. The nature of the process creates substantial difficulties for creditors faced with virtually instant changes in the law in light of the enforcement approach reflected in TILA. The TILA enforcement mechanism gives individuals the right to recover a statutory penalty for any violation in an amount equal to two times the total finance charge of the transaction, but not less than $100 nor more than $1000.[8] In addition, the law permits class actions in which consumers can

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[6] Subsequent assignees are liable for violations that are apparent on the face of an assigned instrument. 15 U.S.C. §1614.

[7] That process includes legal analysis; review of the suitability of the change for personnel who complete the form; printing new forms; physical distribution of the forms often to a number of different branches, offices and dealerships (accompanied by retrieving and destroying obsolete forms); personnel retraining necessitated by the change; and, if it affects certain information, the reprogramming of computer terminals used by many creditors to complete consumer credit forms.

[8] 15 U.S.C. §1640(a)(2)(A). Actual damages are also permitted under TILA, 15 U.S.C. §1640(a)(1); however, on the basis of extensive experience with TILA litigation, *Amici* respectfully submit that this provision is very rarely used, since, as here, such damages are virtually never incurred.

recover up to the lesser of $500,000 or 1% of the creditor's net worth,[9] without any limit on the number or size of the class and, conceivably, on the number of class actions that might be asserted. Perhaps more important, TILA also allows consumers to recover their attorneys' fees and costs.[10] As a result, for any conceivable technical violation — wholly in the absence of harm or injury — a consumer and his or her lawyer may recover the penal sum permitted and fees for bringing the action.[11] This enforcement mechanism, driven by economic incentives, creates concerns based on more than abstract theories; in fact in the last nine years, more than 15,000 lawsuits have been initiated in Federal courts alone,[12] and no reliable statistics are available to indicate the number of actions brought in State court, or brought as counterclaims to collection actions in State or Federal courts, or raised in the course of bankruptcy proceedings. In short, the amount of litigation has been enormous and the costs to both creditors and the judicial system have been staggering.

The case at bar offers an example of the cumulative effect of the foregoing factors. The claimed violation is a failure to include the requested disclosure on the face of the contract, although it appears on the reverse side. At the time relevant to this proceeding, this alleged defect was un-

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[9] 15 U.S.C. §1640(a)(2)(B).

[10] 15 U.S.C. §1640(a)(3).

[11] Courts have held that they have no discretion regarding the imposition of civil liability if they find a violation of TILA, no matter how technical. *See, e.g., Grant v. Imperial Motors*, 539 F.2d 506, 510 (5th Cir. 1976).

[12] 1975 *Annual Report of the Director*, Administrative Office of the United States Courts, Table 32, at 221; 1980 *Annual Report of the Director*, Administrative Office of the United States Courts, Table 27, at 71. From 1972 through June 30, 1980, precisely 15,918 cases were brought in the TILA reporting category. The TILA category also includes some odometer fraud cases, under the Motor Vehicle Information and Cost Savings Act, and cases filed under the Interstate Land Sales Full Disclosure Act. Based on *Amici* experience in this area and informal conversations with staff at the Administrative Office, virtually all cases in this reporting category involve TILA claims.

doubtedly found in virtually every secured consumer credit contract in the country.[13] Although some creditors have started to respond to what *may* be a change in law, changes have not been made in one circuit that has held disclosure is not required,[14] in the circuits that have not considered this question and by smaller creditors or others unable to react quickly. It seems likely that the vast majority of contracts continue to have the clause and that, if covered by TILA, it is not displayed in a technically correct way. An instant change requiring "disclosure" of this clause, would adversely affect literally millions of outstanding consumer credit contracts. These contracts, executed for terms as short as six months and as long as 30 years, present continuing sources of creditor exposure[15] for what is at the very best a questionable and artificial characterization of a trivial interest.

In short, if the practice identified by Respondents is a violation, it is one shared by millions of forms used within the past year and still in use in consumer transactions across the nation. Respondents' contentions, if accepted, would im-

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[13] Respondents have cited a single contract roughly contemporaneous with the one involved in this case that discloses unearned insurance premiums as security interests. *Brief In Opposition To Petition For A Writ Of Certiorari* at 8. From that one contract, Respondents infer that creditors were "routinely disclosing these matters." *Id.* On the basis of extensive experience and direct knowledge of the industry, *Amici* respectfully submit that the single contract cited demonstrates an exception to what was and has been virtually uniform industry practice of not treating interests in unearned premiums as "security interests" or disclosing them as such.

[14] *See James* v. *Ford Motor Credit Co.*, Civ. No. 78-1806 (10th Cir. June 24, 1980), *reh. denied* (10th Cir. July 21, 1980). This case is reproduced in the *Petition For A Writ Of Certiorari* at A-48.

[15] Debtors generally may assert TILA violations as counterclaims otherwise barred by its one-year statute of limitations. 15 U.S.C. §1640(e). *See generally* 3 *Moore's Federal Practice* ¶ 13.11 at 13-245 (2d. ed. 1980). Cases permitting a TILA-based counterclaim without regard to the statute of limitations are listed in *Plant* v. *Blazer Financial Services, Inc.*, 598 F.2d 1357, 1364 n.13 (5th Cir. 1979). This, combined with long term credit transactions, exposes creditors to liability in connection with all outstanding credit transactions.

mediately expose all creditors to liability and supply the incentive to litigate to very large numbers of persons who have suffered no harm whatsoever.

II. BY ATTEMPTING TO DEVISE A FEDERAL COMMON LAW OF SECURITY INTERESTS, THE COURT BELOW IMPROPERLY CREATED A DISCLOSURE REQUIREMENT NOT FOUND IN TILA, IN DIRECT CONTRAVENTION OF AUTHORITATIVE PRONOUNCEMENTS OF THE FEDERAL RESERVE BOARD

A. Neither The "Express Language" Of TILA Nor That Of The Implementing Regulation Requires The Disclosure Of The Disposition Of Unearned Insurance Premiums As A Security Interest

In order to provide meaningful and conspicuous credit cost disclosures, TILA identifies a handful of key consumer credit terms and requires their disclosure, including "security interest[s]."[16] Specifically, TILA requires only that a creditor provide a "description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates."[17] In identical language, Regulation Z requires this disclosure,[18] and it generally defines "security interest" as "any interest in property which secures payment or performance of an obligation" and lists the types of interests disclosable as security interests.[19]

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[16] 15 U.S.C. §§1638(a)(10), 1639(a)(8).

[17] *Id.*

[18] 12 C.F.R. §226.8(b)(5).

[19] 12 C.F.R. §226.2(gg) defines "security interest" as follows:

> "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the

Neither TILA nor Regulation Z includes incidental interests in "unearned insurance premiums" in the definition of security interest.[20] The transaction in this case does involve collateral included in this definition, an automobile, and it was properly disclosed. It is beyond reasonable dispute that Congress intended the security interest disclosure to inform consumers of the central property at risk if they fail to meet their obligations — here, an automobile.[21]

Thus, applied literally, no "express language" in TILA or Regulation Z creates the disclosure requirement asserted by the Respondents, as required by *Ford Motor Credit Co.* v.

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sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

[20] Moreover, the regulatory definition does not include any similarly tangential, incidental interests. Included interests fall into three categories: (a) consensual security interests (*e.g.*, Uniform Commercial Code security interests, mortgages); (b) confessed liens; and (c) security interests arising by operation of law (*e.g.*, mechanic's liens). *Anthony* v. *Community Loan and Investment Co.*, 559 F.2d 1363, 1366, *reh. en banc denied*, 564 F.2d 416 (5th Cir. 1977). These security interests impose a lien upon, a risk to or a charge against the property that is the subject of the transaction. *Rounds* v. *Community National Bank in Monmouth*, 454 F.Supp. 883, 888 (S.D. Ill. 1978). Under the established rule of *ejusdem generis*, additional interests must be of the same nature as the items listed. An assignment of unearned insurance premiums for insurance on the collateral that secures the debt is not similar to these significant interests. This incidental interest bears no resemblance to the customary and usual meaning of "security interest."

[21] Recent Congressional commentary on the *existing* version of TILA supports this common sense interpretation. In describing the need for a clarification of the security interest disclosure requirement, the author of several simplification efforts, Senator J. Garn (R-Ut.), made clear that these modifications were being made *not* to change the law, but rather to correct misinterpretations of the law. Referring specifically to a court case that "required the creditor's right in property insurance proceeds and unearned property insurance premiums, to be disclosed as a 'security interest'," the Senator stated, "*Although as presently written the law does not require that result*, S. 108 [the Truth in Lending Simplification and Reform Act] should prevent such ludicrous interpretations. . . ." 125 *Cong. Rec.* S4990, 96th Cong., 1st Sess. (1979) (emphasis added).

Milhollin, 444 U.S. 555, 560 (1980) ("*Milhollin*"). Literal application is necessary to avoid the danger inherent in the "express language" test that courts will subvert the administrative interpretive process by, in each case, determining that an issue is "covered" by "express language." That potential — which created the substantive issue addressed in *Milhollin* when lower courts "found" the acceleration disclosure requirement *in* the law[22] — can be avoided *only* by a holding that TILA or Regulation Z must, by specific language, create a disclosure requirement. Only if a requirement is found in the exact words of TILA or Regulation Z should a court be allowed to avoid recourse to the extensive pattern of administrative interpretations provided by the Federal Reserve Board. The alternative is to return to the chaos that characterized the field prior to *Milhollin*[23] and would make that decision meaningless.

Having concluded that express language does not create the asserted requirement, the Court in *Milhollin* prescribed the appropriate analytical framework, the consideration of the "implicit character of the statutory scheme." 444 U.S. at 560. Petitioners' Brief carefully adheres to that framework and properly concludes there was no violation of TILA. Although in full agreement, *Amici* will not repeat the arguments advanced by Petitioners. *Amici* respectfully submit that the disclosures provided by Petitioners, reflecting an industry-wide practice, are consistent with the appropriate application of both the letter and spirit of TILA's disclosure requirements.

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[22] *St. Germain* v. *Bank of Hawaii*, 573 F.2d 572 (9th Cir. 1977), the case relied on by the appellate court in *Milhollin*, decided that the required disclosure of the "right of acceleration" could be found in reading Regulation Z, a conclusion rejected by this Court. *Compare* 573 F.2d at 576 *with* 444 U.S. at 562.

[23] For a discussion of these problems, *see Brief Of The Consumer Bankers Association As Amicus Curiae, Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980) (No. 78-1487).

B. The Federal Reserve Board Concluded That State Law Determined What Constituted A "Security Interest" Under TILA. The District Court Held That, Applying Only State Law, There Was No Security Interest

The Court's decision in *Milhollin* points inescapably to the conclusion that the decision of the court below should be reversed. *Milhollin* recognized that the need for clarity and certainty in the highly technical area of consumer credit cost disclosures could be met only in the manner intended by Congress, through administrative pronouncements.

In implementing TILA, the Federal Reserve Board has devised a variety of interpretive devices to provide guidance to creditors. In this case, Unofficial Staff Interpretations, reflecting the Board's informed judgment on technical details, have provided that State law governs the issue as to whether there is a security interest to be disclosed under TILA.[24] The District Court in its initial decision found that no security interest existed under the applicable State law. Therefore, the court below improperly held Petitioners' failure to disclose that "security interest" to be a violation of TILA.

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[24] As discussed by the Petitioners, the Federal Reserve Board has clearly signaled a modified position on the duty to disclose and the desirability of disclosing an interest in unearned insurance premiums. *See* Official Staff Interpretation No. FC-0173 (Proposed), 45 *Fed. Reg.* 63295 (September 24, 1980). Apparently in response to contrary court decisions referenced in the Interpretation (which essentially ignored staff interpretations), Board staff has reexamined the most appropriate interpretation of the security interest disclosure requirement in view of TILA's credit shopping purpose. As reflected in the proposed Interpretation, it seems clear that the Board staff has concluded that disclosure would not further that purpose. Petitioners' Brief correctly concludes that the Board has modified its earlier view, now deciding that disclosure is not necessary. Due to the review of this issue by the Court, however, the Board has deferred temporarily final adoption of the Interpretation, indicating that it would be "inappropriate to take final action on the interpretation at this time." 45 *Fed. Reg.* 84074 (December 22, 1980). If the recent modification is not recognized, as discussed herein the Board's previous position similarly points to reversal of the decision below.

1. The Decision Below Is Contrary To This Court's Decision In Milhollin, *Which Recognized The Federal Reserve Board And Its Staff As The Authoritative Interpretive Source In Identifying TILA Disclosure Requirements*

In interpreting statutes, courts have consistently relied upon administrative pronouncements, particularly when, as here, the agency is construing its own regulation.[25] In *Milhollin*, the Court, recognizing the unique nature of TILA requirements, held that deference to the Federal Reserve Board "is especially appropriate in the process of interpreting the Truth in Lending Act and Regulation Z." 444 U.S. at 565. Noting the highly technical and often nonsubstantive disputes under TILA and the need for expertise in determining what will actually enhance meaningful disclosure (as opposed to merely adding unimportant and confusing information),[26] the Court concluded that these close decisions should be left to the Federal Reserve Board and its staff. 444 U.S. at 568-69.

The conclusions reached by the Court in *Milhollin* are no less valid now than they were less than a year ago when that decision was rendered. Both creditors attempting to comply with TILA and consumers seeking comparable credit cost information must be able to look to a single set of consistent rules. Generally, the precise shape of the rule is far less important than that there be one specific, understandable rule, making TILA uniquely well suited to reliance on ad-

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[25] *See, e.g., Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Power Reactor Development Co.* v. *Electrical Workers*, 367 U.S. 396, 408 (1961); and *Bowles* v. *Seminole Rock and Sand Co.*, 325 U.S. 410, 413-14 (1945).

[26] One of the most difficult issues under TILA is attempting to convey important credit information to consumers in a meaningful, usable way without overwhelming them with too much detail. As recognized by both Congress and this Court, disclosure of all or relatively unimportant information results in "information overload" preventing the effective communication of *any* information. *See* S. Rep. No. 96-73, 96th Cong., 1st Sess. 3 (1979). "*Meaningful* disclosure does not mean *more* disclosure." *Milhollin*, 444 U.S. at 568 (emphasis by the Court).

ministrative rulemaking, *Milhollin*, 444 U.S. at 565, 568-69, which is essential to provide uniform and comprehensive guidance to creditors attempting to discern and discharge TILA responsibilities.

The technical detail involved in meeting those responsibilities requires the use of various types of administrative tools, the first being Regulation Z.[27] "Even Regulation Z, however, cannot speak explicitly to every credit disclosure issue." *Milhollin*, 444 U.S. at 560. In light of the inability to cover all possible questions in the Regulation, Congress empowered the Federal Reserve Board and its staff to adopt interpretations. *Id.*, 444 U.S. at 566-67.

The Federal Reserve Board has determined that it may best provide interpretive assistance by issuing several different types of interpretations: Official Board Interpretations, Official Staff Interpretations and Unofficial Staff Interpretations (often referred to as "FRB Public Information Letters"). The Board has established criteria to determine the kind of interpretations to be issued in a specific case.[28] Internal Board decisions as to the type of interpretation[29] are based upon considerations of efficient administration and do not purport

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[27] *See Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 365 (1973).

[28] Board Interpretations generally deal with policy matters. *See* 43 *Fed. Reg.* 18539, 18540 (May 1, 1978). The two types of Staff Interpretations are described in Regulation Z, and are differentiated on the basis of the type of response being sought and the time frame within which it is needed. *See* 12 C.F.R. §226.1(d).

[29] This determination may change or a more definitive response may be necessary. For example, when this case was accepted for Court review, the Federal Reserve Board had already started to provide a definitive Official Staff Interpretation dealing with the disclosure treatment for unearned insurance premiums. *See* Official Staff Interpretation No. FC-0173 (Proposed), 45 *Fed. Reg.* 63295 (September 24, 1980). Apparently, the Board staff felt initially that the "unearned insurance premiums" issue was not of sufficient importance to justify anything but a restatement of its general position to refer to State law to determine whether a "security interest" existed. As noted above, the Board has temporarily deferred further refinement of its position pending a decision in this case. *See* n.24 *supra*.

to assign differing or relative levels of interpretive value to one kind of interpretation over another. Rather, various types of interpretations have been provided due to the magnitude and variety of the inquiries involved — including the degree of technicality and the impact on existing or new policies.

The absence of a distinction in the interpretive value of Unofficial as opposed to Official Staff Interpretations is consistent with the need for definitive administrative interpretation of TILA. This was underscored in *Milhollin*, which made clear that the staff's expertise was to be followed in virtually every case. "Unless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive. . . ." *Milhollin*, 444 U.S. at 565. No distinction between Official or Unofficial Staff Interpretations was made in the Court's discussion of the substantive issue being addressed in *Milhollin*.[30] Indeed, there the Court looked to and relied upon a theory contained *not* in the single Official Staff Interpretation cited in that case, but rather in an Unofficial Staff Interpretation.[31]

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[30] As recognized in *Milhollin*, for the purpose of defense to civil liability a different stature is attributed to interpretations that are designated as "official." *See Milhollin*, 444 U.S. at 567 n.10; 15 U.S.C. §1640(f). However, this discussion is focused on the *interpretation* of the statutory requirements, and *not* a *question of defense* when it has been established that a violation has occurred. That critical point was emphasized in *Milhollin*.

> The enactment and expansion of §1640(f) *has significance beyond the express creation of a good-faith immunity*. That statutory provision signals an unmistakable congressional decision *to treat administrative rulemaking and interpretation under TILA as authoritative*. Moreover, language in the legislative history evinces a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation. *Milhollin*, 444 U.S. at 567-68 (emphasis added; footnotes omitted).

[31] *Milhollin* involved disclosure of the creditor's right of acceleration. Two theories were advanced in favor of creating a duty to disclose it: that disclosure was mandated by a portion of Regulation Z dealing with default and similar charges, 12 C.F.R. §226.8(b)(4), and that it was covered by a provision dealing with prepayment rebate disclosures, 12 C.F.R. §226.8(b)(7). The only Official Staff Interpretation involved dealt with the responsibility to disclose under §226.8(b)(4). Thus, the application of that

Accordingly, both on the basis of sound administration and implementation of TILA and this Court's pronouncements, not followed by the court below and expressly rejected by at least one other court,[32] the authoritative determinations of the Federal Reserve Board and its staff should be followed, including those reflected in Unofficial Staff Interpretations.

2. In Unofficial Staff Interpretations The Federal Reserve Board Ruled That State Law Governs Whether A Security Interest Exists For TILA Disclosure Purposes

The pronouncements of the Federal Reserve Board, including one addressing the specific issue before the Court, have held that State law determines whether any right, interest or contract provision constitutes a "security interest" for the purpose of TILA disclosures.[33] This interpretation is totally

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letter alone would have defeated only one of the two arguments in favor of disclosure, both of which ultimately were rejected by the Court. Moreover, the theory adopted by the Court and discussed in the concurring opinion issued by Mr. Justice Blackmun and joined by The Chief Justice, was that the creditor's "policy or practice," rather than the technical terms of the contract, were to be properly reflected in the disclosures. The former position — adopted by the Court — cannot be found either literally or conceptually within the *Official* Staff Interpretation involved. Rather, that position evolved from Unofficial Staff Interpretation No. 1208, referred to and quoted by the Court. *Milhollin*, 444 U.S. at 563-65 n.8. Therefore, *Milhollin* was based, at least in large part, on administrative interpretations as reflected in *Unofficial* Staff Interpretations.

[32] *See Souife* v. *First National Bank of Commerce*, 628 F.2d 480, 483 (5th Cir. 1980). The Fifth Circuit has deferred further consideration of a petition seeking rehearing *en banc*, pending a decision in this case. Unpublished Order signed by Anderson, C.J. (December 5, 1980).

[33] Several Federal Reserve Board staff letters defer to State law in determining the existence of a security interest and its disclosure. *See* FRB Public Information Letter No. 114, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,159 (September 10, 1969) (whether an agreement not to encumber or transfer property is a security interest depends on State law); FRB Public Information Letter No. 829, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,151 (August 22, 1974) (disclosure must accurately reflect the type of security interest acquired under State law);

appropriate, since State law governs all other substantive aspects of consumer credit transactions.[34]

That view first became clear on September 10, 1969, when the Board through its staff indicated that whether specific interests constituted a "security interest" "depends on State law."[35] Following that and a number of similar

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FRB Public Information Letter No. 1053, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,393 (May 28, 1976) (disclosure must accurately state the scope of a security interest under State law); FRB Public Information Letter No. 1080, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,420 (July 14, 1976) (appropriate description of security interest depends upon how it is characterized by applicable State law); FRB Public Information Letter No. 1125, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,475 (November 2, 1976) (disclosure must accurately describe creditor's rights under State law); FRB Public Information Letter No. 1145, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,520 (January 11, 1977) (look to rights acquired under State law); FRB Public Information Letter No. 1151, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,531 (January 31, 1977) (Regulation Z leaves to State law the definition of "after acquired" property); FRB Public Information Letter No. 1227, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,666 (July 29, 1977) (whether a confession clause is a security interest depends upon its effect under State law); FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,736 (November 23, 1977) (whether the assignment of returned and unearned insurance premiums and the contractual right to insurance proceeds are security interests is a matter of State law).

[34] With limited exceptions, TILA mandates disclosure and not substantive provisions that are and have always been established by the States. *See* 1 *Cons. Cred. Guide (CCH)* ¶ 1005 at 3012. As with other contract terms, TILA does not alter State law regarding security interests; it merely requires their disclosure. Since a consumer will shop for credit among creditors who will virtually always be located in the same geographic area, and most certainly will be applying the same State law, there is no lack of uniformity in the information received by the consumer. Moreover, insofar as different information is disclosed, this results *not* from differences in the disclosure requirement, but rather from the lack of uniformity in State law prescribing contract rights, including those involving security interests. Uniform Federal disclosure requirements do not create those State law differences, they merely reflect them.

[35] FRB Public Information Letter No. 114, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,159 (September 30, 1969).

opinions, the Board staff dealt with precisely the issue before the Court:

> What constitutes adequate identification of the *type* of security interest acquired by the creditor depends upon how relevant State law would describe the security interest. *Note that a more fundamental matter in these circumstances may be to determine whether a security interest exists at all and, if so, to identify the property subject to such interest.* . . . [A]ssignment of returned and unearned premiums *may* transfer to the creditor such an interest. However, staff believes *these questions would be better addressed as a matter of State law.* FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 31,736 (November 23, 1977) (all but initial emphasis added).

Thus, the Federal Reserve Board concluded that *State* law is to determine whether a security interest exists.[16]

Problems have arisen when some Federal courts attempted to devise a form of Federal common law of security in-

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[16] The court below incorrectly suggested that another staff letter on an "analogous" issue supported its conclusion that a security interest is involved here. 617 F.2d at 1286. That letter, however, appears to deal with a significantly different set of circumstances, involving a credit transaction undertaken for the express purpose of acquiring insurance. A letter issued July 22, 1970 (FRB Public Information Letter No. 377, [1969-1974 Transfer Binder] *Cons. Cred. Guide (CCH)* ¶ 30,555 (July 22, 1970)), indicated that if a customer is purchasing a policy "with the proceeds of his loan" and the *ownership* of the policy is to be retained by the creditor, the creditor's ownership should be disclosed. The letter apparently deals with a consumer obtaining a loan to purchase an insurance policy, with the policy being used as the only collateral. In that case, the object of the credit transaction that is being looked to as collateral — the ownership of an insurance policy — would be disclosed, just as in this case the automobile involved was disclosed. In addition, the letter states that the appropriate disclosure involved "ownership" of the policy by the creditor, a factor not present in the instant case. In any event, this letter is the only expression contrary to the series of letters that had directed creditors to look to State law. Insofar as it may be read to be inconsistent, it has been modified by subsequent staff interpretations, including those described above. *See* n.33 *supra*.

terests, at least for purposes of TILA disclosure.[37] Beginning with a single case that dealt with the assignment of a "homestead and exemption" provided under State law, several courts purported to create a new rule — apparently used only for credit disclosures — that any "valuable economic right" must be disclosed as a security interest, regardless of the application of State law.[38]

That determination to formulate a security interest test using Federal law — contrary to the pronouncements of the Federal Reserve Board staff — produced *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) ("*Edmondson*"). That case was cited as the foundation of the final decision by the District Court in this case[39] and the basis of the decision now before the Court for review.[40] *Edmondson*, despite clear Federal Reserve Board interpretations, prefaced its examination of the interest involved under Federal law, which it held to be controlling, by declaring the absence of any need even to look at State law:

> Fortunately we need not tarry over the complexities of Georgia's commercial law. . . . 577 F.2d at 293.

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[37] The same effort in another area was recently turned aside by this Court in *Butner* v. *United States*, 440 U.S. 48 (1979). Under the Federal Bankruptcy Act, the Court required the courts to look to State law to define and determine whether the creditor acquired a "security interest": "Property interests are created and defined by state law." 440 U.S. at 55. The rationale of that case applies with equal force to the issue of Federally mandated disclosure of the provisions of State substantive law. *See* n.34 *supra*.

[38] *Elzea* v. *National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978). That case held that characterizations of State law "are not determinative of whether a creditor holds a security interest under Regulation Z's definition." 570 F.2d at 1249-50.

[39] *See* J.A. 33. The District Court also cited *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978), a companion case to *Edmondson* decided on the same day, which merely found facts "virtually identical" to *Edmondson* and summarily followed it. *Id.* at 297-98.

[40] 617 F.2d at 1283-85.

The decision to devise a Federal law of security interests similarly undergirds the holding of the Court of Appeals for the Eighth Circuit in *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556 (8th Cir. 1980).

> While we recognize that state law may be a factor in determining whether a security interest has been created in a given situation, an interest may, nevertheless, be a security interest for purposes of TILA even though it is not an enforceable security interest under state commercial law. 629 F.2d at 559.[41]

In short, the cases that have actually dealt with the issue of whether any interest in unearned insurance premiums is a "security interest"[42] are based solely on a premise in direct conflict with the Federal Reserve Board's determination that these matters should be resolved under State, not Federal, law. In view of the Congressional decision, recognized in *Milhollin*, that administrative interpretation of TILA is to be decisive, State law controls "security interest" characterizations under TILA.

3. The District Court Found That, Under State Law, No Security Interest Existed. A Fortiori, *No Disclosure Is Required*

The District Court in its initial decision found that under the applicable State law the interest involved here *was not a*

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[41] The court below made a similar statement, 617 F.2d at 1284, citing its decision in *Bulger* v. *Thorp Credit Inc.*, 609 F.2d 1255 (7th Cir. 1979). Neither court provided any explanation as to how disclosing this information to a consumer would be at all helpful — for credit shopping or otherwise — if there is no "security interest" under State contract law.

[42] Although often cited as the genesis of the case law in this area, *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3rd Cir. 1977), did not involve a dispute as to the existence of a security interest. The only issue involved there was the appropriate disclosure of a security interest *that was conceded to exist*, apparently under applicable Pennsylvania law. *See* 425 F.Supp. 461, 467 n.11 (W.D. Pa. 1976). There, the *creditor stipulated* that the interest involved under applicable law *was a security interest*. The issue addressed in *Edmondson*, *Murphy* and in the court below simply was not before the court in *Gennuso*.

security interest.[43] That finding was undisturbed by the trial court's subsequent decisions and the decision of the Seventh Circuit Court of Appeals.[44]

Accordingly, following Federal Reserve Board interpretations, the policies recognized in *Milhollin*, and the District Court's determination as to the proper characterization under State law, no security interest disclosure is required with respect to unearned insurance premiums for the simple reason that there is no security interest.

III. IF THE PRACTICE FOLLOWED BY PETITIONERS IS FOUND TO BE A VIOLATION OF TILA, THE DISCLOSURE REQUIREMENT INVOLVED SHOULD BE PROSPECTIVE ONLY

A. The Analysis Of *Chevron* By The Court Below Was Incorrect

As outlined above, *Amici* submit that the court below is incorrect on the merits. But assuming the soundness of its decision, it should be given only prospective effect. For the reasons set forth in Petitioners' Brief, the factors identified in *Chevron Oil Co.*, v. *Huson*, 404 U.S. 97, 106-07 (1971) ("*Chevron*"), dictate that any holding that disclosure is required should be given prospective application only. Moreover, the court below incorrectly took the view that all three *Chevron* factors are essential to a prospective judicial

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[43] J.A. 9. Viewing the clause under Illinois law in the context of "the contract or in the purchase and sale of automobiles," and citing an Illinois statute dealing with insurance premium refunds, the court concluded it was "rather clear that unearned insurance premiums do not constitute a security interest in the automobile." *Id.* at 12.

[44] After its first decision, the District Court issued two other opinions. J.A. 19 and 33. In the first, the court made clear that *Edmondson*, and its companion case, *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978), both of which rejected the applicability of State law, were the basis for the reversal of its initial decision. No further reference to State law was made by the District Court and the court below did not address the issue, since, in following *Edmondson*, it found State law characterizations "not determinative." 617 F.2d at 1284.

ruling. 617 F.2d at 1289. In fact, as elaborated below, the purpose of the doctrine announced is the touchstone of analysis, and one or more of the factors may be decisive. For example, under proper circumstances, a new doctrine that involves *either* inequity *or* the absence of any further legitimate purpose can preclude retrospective effect.

The Seventh Circuit held that its view of the assignment of unearned premiums as a "security interest" was "foreseeable." From this the court below reasons that Petitioners did not satisfy the standards set forth in *Chevron*. 617 F.2d at 1289. The position urged by Respondents and assumed by the Seventh Circuit is simply unrealistic. It is premised upon three district court opinions, two in the Northern District of Georgia (reaching opposite results)[45] and one in the Western District of Pennsylvania (in which the question of the existence of a security interest was not even in issue).[46] These cases, as outlined in Petitioners' Brief, are not controlling and were in conflict even at that time. Indeed, the District Court in this case initially agreed with Petitioners' views on the disclosure issue before reversing itself in light of the subsequent Fifth Circuit decision in *Edmondson*.

Even if the three district court cases cited by the court below had been consistent and on point, however, *Amici* would respectfully submit that they should not be given the effect of altering disclosure requirements for every creditor in the United States. TILA litigation arises in thousands of contract actions between private parties in a multitude of State courts and in all 516 Federal district courts. Given their volume, diversity and relative obscurity, trial court decisions simply do not notify the universe of a changed requirement. More important, they should not trigger the expensive, cumbersome process of implementing a change.

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[45] *Edmondson* v. *Allen-Russell Ford, Inc.*, Civ. No. C75-940A (N.D. Ga., April 29, 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979), and *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978).

[46] *See Gennuso* v. *Commercial Bank & Trust Co.*, 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd*, 566 F.2d 437 (3rd Cir. 1977); n.42 *supra*.

The Court should consider the consequences of the Seventh Circuit's position. If a creditor must react to any court decision anywhere in the nation from any judge, no matter how remote the court may be geographically from the creditor's business, and regardless of whether the court's opinion is published or disseminated, then creditors are faced with a truly impossible task.[47] Given the magnitude of TILA litigation pending in the courts, creditors will simply be unable to achieve the certainty and uniformity TILA was designed to foster.

B. Under Established Principles Of Judicial Discretion Extending Beyond *Chevron*, A Decision Requiring Disclosure Should Be Prospective Only

A more fundamental basis for reversal of the court below on this issue is the fact that *Chevron* dealt with a conventional lawsuit involving — as do most lawsuits — the question who is to bear a loss that has been suffered. As the Seventh Circuit observed, the *Chevron* considerations are controlling in determining such a case. But the case at bar, like most TILA cases, does not deal with deciding who will bear an existing loss. Rather, it presents the question as to whether a loss is to be *created*. This is true because TILA awards its statutory penalty plus attorneys' fees to consumers involved in a credit transaction that does not comply with the technicalities of TILA, regardless of whether the absence of technical compliance affected the transaction or caused any

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[47] The law of prospective application of appellate decisions is not that strict. For example, in *Kacher* v. *Pittsburgh National Bank*, 545 F.2d 842 (3rd Cir. 1976), a debtor whose collateral on a loan had been repossessed and sold by a creditor pursuant to the Pennsylvania replevin statute sought to recover punitive and compensatory damages on the grounds that the procedure followed was unconstitutional under *Fuentes* v. *Shevin*, 407 U.S. 67 (1972). The court refused to apply *Fuentes* retrospectively, even though the debtor persuasively argued that the *Fuentes* decision was clearly foreshadowed by the decisions in *Sniadach* v. *Family Finance Corp.*, 395 U.S. 337 (1969), and *Goldberg* v. *Kelly*, 397 U.S. 254 (1970).

injury or damage. This fact argues persuasively for limiting novel disclosure requirements to prospective effect.

1. A Retrospective Disclosure Requirement Would Not Promote TILA Purposes As Identified By Congress

The policy behind the TILA penalty mechanism is essentially deterrent or prophylactic in nature. As such, the question whether novel TILA disclosure requirements should be given standard retrospective effect is governed by the line of cases that deals specifically with rules of law that are prophylatic in nature. There is ample precedent for the proposition that judicial developments in these areas are to be given only prospective effect.

Notable among these cases is *United States* v. *Peltier*, 422 U.S. 531 (1975), where the Court declined to apply the rule announced in *Almeida-Sanchez* v. *United States*, 413 U.S. 266 (1973),[48] even though *Peltier* was pending on appeal when the *Almeida-Sanchez* decision was released. The Court expressly focused on "the purposes served by the exclusionary rule." 422 U.S. at 538. Because the purpose of the rule was to deter law enforcement personnel from violating the constitutional rights of others, retrospective application would not further that purpose. To the same effect is *Linkletter* v. *Walker*, 381 U.S. 618 (1965), which declined to give retrospective application to *Mapp* v. *Ohio*, 367 U.S. 643 (1961), which for the first time held State law enforcement officers subject to the exclusionary rule with respect to unreasonable searches and seizures.

In cases involving the application of constitutional principles to criminal trials, the Court has consistently focused on the purpose of the recently announced rule and its impact on the reliability of a conviction. The Court has retrospectively applied new rules of criminal procedure "fashioned to correct serious flaws in the fact-finding process at trial." *Stovall* v.

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[48] *Almeida-Sanchez* held that a warrantless search of an automobile conducted 25 miles from the border with Mexico without probable cause violated the Fourth Amendment.

Denno, 388 U.S. 293, 298 (1967). Thus, for example, the rule announced in *Bruton* v. *United States*, 391 U.S. 123 (1968) (which held that an admission by one defendant in a joint trial which implicated a co-defendant violated the co-defendant's right of cross-examination) was applied retrospectively in *Roberts* v. *Russell*, 392 U.S. 293, *reh. denied*, 393 U.S. 899 (1968), because the rule was designed to eliminate a practice in criminal trials that was considered to affect adversely the reliability of convictions. Cases involving the exclusionary rule, on the other hand, do not affect the reliability of convictions, because illegally obtained evidence does not lose its probative value by the manner in which it is acquired.

This distinction illustrates the inquiry necessary to decide whether to limit a decision announcing a new rule to prospective effect. The decision is not one that is guided by an application of sterile and inflexible standards from *Chevron* or anywhere else. Rather it is the product of a case-by-case consideration of the purposes to be served by the new rule and a careful weighing of the equities involved. And in dealing with prophylactic rules, at bottom, "[t]he purpose of the new rule is the bench mark for its application prospectively or retrospectively." *United States* v. *Miller*, 492 F.2d 37, 41 (5th Cir. 1974), *cert. denied*, 422 U.S. 1056 (1975).

The doctrine that the purpose of the new rule may itself dictate prospective application has been developed principally in criminal cases. But this simply reflects the fact that a typical private civil suit — such as *Chevron* itself — involves a rule of law whose purpose is corrective, not prophylactic. Otherwise stated, most civil litigation involves substantive rules designed to remedy wrongs and redress injuries. TILA violations, at least those of the type involved in the case at bar, are wholly different and more similar to the exclusionary rules of criminal procedure.

The fundamental goal of TILA is to insure disclosure of credit terms in a manner that will enable the consumer to

make comparisons and enter transactions knowledgably.[49] This can only happen as to transactions that have not yet occurred. Prospective relief thus serves this purpose fully as well as does retrospective relief.[50] A second purpose, which is a corollary of the first, is to deter violations of TILA by creditors. This is accomplished by the provisions authorizing penalties in private lawsuits, thus encouraging borrowers to act as "private attorneys general," and by provisions for the recovery of attorneys' fees.

TILA's purpose to deter violations was not designed to give a windfall to borrowers. Nothing could be further from the intent of Congress. "The penalty provisions of the Act were designed as an enforcement mechanism, not as a source of windfall gains for obligors." *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 880 (7th Cir. 1976). To avoid such a result, and promote TILA's goals, if the decision below is affirmed it should be applied prospectively. To be sure, to comport with TILA's encouragement of private attorneys general, the Respondents should be permitted to benefit from any change in the law they produce. But others should not be permitted to recover a civil penalty unless they are able to demonstrate actual harm, in which case redress is provided under a different provision of TILA.[51]

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[49] "It is the purpose of [TILA] to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." 15 U.S.C. §1601. The Seventh Circuit recognized that the requirement announced there could not seriously be suggested to further the underlying purposes of TILA. 617 F.2d at 1293 (Cudahy, J., concurring). Thus, there is no question that application of the new rule retrospectively would *not* further the fundamental purposes of TILA.

[50] *Travis* v. *Trust Company Bank*, 621 F.2d 148 (5th Cir. 1980), and *Brown* v. *Termplan, Inc.*, 459 F.Supp. 160 (N.D. Ga. 1978), both cited by Respondents, hold that TILA's purposes are served by retrospective application, but neither case offers an adequate explanation of how retrospectivity deters violations of TILA by creditors.

[51] 15 U.S.C. §1640(a)(1).

2. Retrospective Application Of A Disclosure Requirement Has A Punitive Effect On Creditors And Gives A Windfall To Litigating Debtors

The basic equities of the situation also favor prospective application of new developments in TILA disclosure requirements. As noted earlier, this case involves a consumer credit transaction like literally thousands of other transactions entered into daily across the country and enormous numbers of these transactions would be affected by the decision below, since widely distributed, preprinted forms are used.[52] In addition, the adoption of a national rule requiring disclosure in this case would be felt by creditors in circuits that have not considered this issue and in at least one circuit that has announced a different rule.[53]

It is obviously impossible and surely not in the national interest that consumer credit grind to a standstill every time a court discovers a new TILA requirement. As a result, if new decisions are not applied prospectively, any decision that disclosure is required under TILA necessarily has a substantial impact on a very large number of contracts that were entered in reliance on a different view of the law.[54] Further, if such a

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[52] To the extent that consumers and their attorneys are unaware of the technical requirement asserted here, a decision by this Court not limited to prospective application affirming the decision below will instantly alert them to it. A highly visible retrospective determination raises the spector that it will set off a series of individual and class actions that could give rise to summary judgments against virtually every creditor in the country.

[53] *See James* v. *Ford Motor Credit Co., supra*, n.14.

[54] Reliance on the generally perceived state of the law has been repeatedly recognized as a basis for denying retrospective effect. For example, in *Bendix Corporation* v. *Balax, Inc.*, 471 F.2d 149 (7th Cir. 1972), *cert. denied*, 414 U.S. 819 (1973), a defendant to a patent infringement suit counterclaimed for alleged antitrust violations. The defendant's counterclaim was strengthened by the decision in *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969), during the pendency of the lawsuit. Because *Lear* expressly overruled the decision of *Automatic Radio Manufacturing Co.* v. *Hazeltine Research, Inc.*, 399 U.S. 827 (1950), the court found that the new rule should not be applied to the case before it. The court concluded

decision is given retrospective effect, it has the potential for the imposition of severe penal sanctions on creditors, who are subject to vast numbers of private actions or to class actions.

Indeed, although at first the analogy may seem overblown, there is significant similarity between the effect of retrospective application of decisional TILA requirements and the statutory scheme held unconstitutional in *Ex parte Young*, 209 U.S. 123 (1908), where the only means by which a State statute could be challenged was in the defense of an enforcement proceeding, during the pendency of which enormous penalties continued to accrue. In each case the creditor under TILA or the challenger under *Ex parte Young* is remitted to a choice either (a) to accede to the position urged by his opponents or (b) to litigate and face the risk of truly staggering penalties if unsuccessful at the end of the day. If not constitutionally necessary it is at least good policy, and judicial discretion in favor of prospective application of new requirements is an appropriate means of preserving the right of creditors to present their positions to the courts without intimidation.

3. A Minimum Ninety-Day Delay In The Effect Of A Final Appellate Decision Reflecting A New Disclosure Requirement Is Both Necessary And Appropriate

If the Court decides that disclosure should be required, but that its decision should be given prospective effect, the further question of when the decision should take effect must be addressed. Because creditors deal with preprinted forms, and any change in the law necessitates a careful revision of those forms followed by printing, distribution and training in the use of the forms, *Amici* suggest that a disclosure should

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that an application of the law of *Lear* would not further the purpose of the new rule, but would simply penalize the plaintiff for its reliance on prior law. *See also Simpson* v. *Union Oil Company*, 377 U.S. 13, 24-25 (1964) (holding that resale price maintenance through a scheme of coercive consignment was illegal under the antitrust laws), and *Lyons* v. *Westinghouse Electric Corporation*, 235 F.Supp. 526, 537 (S.D. N.Y. 1964) (denying retrospective effect to *Simpson*).

be limited in effect to transactions entered beginning at least 90 days from the announcement of the decision (except, of course, for pending cases that raise the same alleged violation). This is the period selected in *McDaniel* v. *Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978), a decision that also addressed a change in TILA disclosure requirements.[55]

In addition, the Court should consider the question of the point in the judicial process appropriate for the initiation of a waiting period for prospective application of a decision.[56] District courts are inappropriate, because their decisions are frequently not published or widely disseminated and generally lack statewide application. Rather, the point from which a prospective rule should begin to run is the finality of a decision of a United States Court of Appeals, unless review by this Court is sought within the statutorily prescribed 90-day period. This mechanism will fully preserve the incentive for consumers to assert their contentions, but creditors engaged in good faith litigation to determine unclear questions of TILA requirements would not be faced with the prospect of accrual of enormous liability while they are still engaged in litigation to determine their rights.

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[55] Congress has recognized both the need for limiting the frequency of changes in TILA requirements and the necessity of adequate lead time within which to implement the change. Recent TILA amendments generally limit regulatory disclosure changes to one time a year (October 1) and establish a mandatory lead time of not less than *six months*. *See* Section 605 of the Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, Title VI, §605, 94 Stat. 168 (amending 15 U.S.C. §1604); S. Rep. No. 96-73, 96th Cong., 1st Sess. 12-13 (1979).

[56] Presumably, if during judicial review the Federal Reserve Board or its staff issues a relevant interpretation, it will control both the resolution of the issue involved and the effective date of the disclosure requirement it imposes or relieves. Moreover, *Amici* respectfully submit that it will be exceedingly difficult as a practical matter for the tens of thousands of creditors all over the country to identify, let alone implement, technical disclosure duties imposed on the basis of one fact situation even if the change is limited to decisions by appellate courts. It seems highly unlikely that new TILA rules, in view of the need for comprehensive rules reflecting the diverse credit market, will become universally applied until they are the subject of Federal Reserve Board action.

CONCLUSION

For all of the reasons stated above, the Court should reverse the decision below.

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No. 80-84

IN THE

Supreme Court of the United States

October Term, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

On a Writ Of Certiorari To The United States Court Of Appeals For the Seventh Circuit

BRIEF OF INDIAN PUEBLO LEGAL SERVICES, INC. AS *AMICUS CURIAE*

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES iii

INTEREST OF *AMICUS CURIAE* 1

ARGUMENT 3

SUMMARY OF ARGUMENT 3

I. If This Court Finds That Creditors Have Violated the Act and Regulation Z, That Decision Should Be Given Full Retroactive Effect 7

A. Introduction 7

B. Creditor Have Failed to Meet the *Chevron Oil* Test 9

1. A Decision Here in Favor of Consumers Would Not Overrule Clear Past Precedent, Nor Is It an Issue of First Impression that Was Not Clearly Foreshadowed 9

2. Creditors Have Failed To Demonstrate Reliance on Clear Past Precedent 12

3. Creditors Have Failed to Demonstate that Full Retroactive Application Will Impeded the Operation of the Act 15

4. The Equities Involved Weigh in Favor of Full Retroactive Application 19

a. Congress and the Board Have Provided Equitable Methods for Creditor Compliance 19

b. Creditors' Conscious Business Decision Will Not Cause Undue Hardship 22

Page

c. The Truth in Lending Simplification Act Does Not Establish Creditors' Good Faith.....24

d. Summary.....25

C. If this Court Finds a Violation of the Act and Determines that its Judgment Is To Be Applied Prospectively Only, That Judgment Should Be Made Applicable To All Presently Pending Lawsuits on this Issue.....25

II. CONCLUSION 29

ADDENDUM OF LEGAL AUTHORITIES

Federal Reserve Board Public Information Letter No. 377 (July 22, 1970)..... A-1

TABLE OF AUTHORITIES

Page

Cases

Angelet v. *Fay*, 381 U.S. 654 (1965) 26

Chevron Oil v. *Huson*,
404 U.S. 97 (1971) 5, 6, 7, 8, 9, 15,
18, 19, 29

Chicot County Drainage Dist. v. *Baxter State Bank*, 308 U.S. 371 (1940) 27

Cipriano v. *Houma*, 395 U.S. 701
(1969) 3, 26, 27

DeStefano v. *Woods*, 392 U.S. 631 (1968).....26

Desist v. *United States*, 394 U.S. 244
(1969) 26

Edmondson v. *Allen-Russell Ford, Inc.*,
No. C75-940A (N.D.Ga. 1976), *aff'd*
557 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951 (1979)..... 6, 11, 13, 21,

Ford Motor Credit Company v. *Milhollin*,
444 U.S. 555 (1980) 9, 13, 17, 20

Foster v. *California*, 394 U.S. 440 (1969).....26

Gennuso v. *Commercial Bank and Trust Co.*,
425 F.Supp. 461 (W.D.Pa. 1976) *rev'd*
566 F.2d 437 (3rd Cir. 1977) 13, 21

Griffin v. *California*, 380 U.S. 609
(1965) 26

Hamling v. *United States*, 418 U.S. 87
reh. denied 419 U.S. 885 (1974).....26

Hannon v. *Security National Bank*,
537 F.2d 327 (9th Cir. 1976) 4

Hanover Shoe v. *United Shoe Mach. Corp.*,
392 U.S. 481 (1968) 8

Hillers v. *Local Federal Savings and Loan Association*, 204 Okla. 615
232 P.2d 626 (1951).....13

Page

James v. Ford Motor Credit Co., Civ. No. 78-1806 (10th Cir. 1980), *reh. denied* (10th Cir. 1980), *petition for cert. filed* 49 U.S.L.W. 3333 (U.S. Oct. 20, 1980) (No. 80-640) 10, 14, 21, 24, 28

James v. United States, 366 U.S. 213 (1961) 27

Jimenez v. Weinberger, 523 F.2d 689, 704 (7th Cir. 1975), *cert. den.* 427 U.S. 912 (1976) 8

Jordan v. Weaver, 472 F.2d 985, 995 (7th Cir.) *rev'd on other grounds sub nom., Adeleman v. Jordan*, 415 U.S. 651 (1974).....8

Kibbe v. Ditto, 93 U.S. 674 (1876) 26

Linkletter v. Walker, 381 U.S. 618 (1965) 26, 27

McGowan v. King, Inc., 569 F.2d 845, 848 (5th Cir. 1978) 4

McDaniel v. Fulton National Bank, 571 F.2d 948 (5th Cir. 1978) *(en banc)* ... 13, 14

Miller v. California, 413 U.S. 15 *reh. denied* 414 U.S. 881 (1973).....26

Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1967) 13

Montoya v. Postal Credit Union, 630 F.2d 745 (10th Cir. 1980) 17

Mourning v. Family Publications Service, Inc., 411 U.S. 356, 364 (1973) 16, 17

Murphy v. Ford Motor Credit Co., 629 F.2d 556, 561 (8th Cir. 1980) 9, 15,

Murphy v. Household Finance Corp., 560 F.2d 206, 210 (6th Cir. 1977) 4

O'Connor v. Ohio, 382 U.S. 286 (1965) 26

Page

Oklahoma Packing Co., v. Oklahoma Gas and Electric Co., 309 U.S. 4 (1939) 26

Rounds v. Community National Bank in Monmouth, 454 F.Supp. 883 (S.D.Ill. 1978) 10

Schaefer v. First National Bank of Lincolnwood, 509 F.2d 1287 (7th Cir. 1975), *cert. den.* 425 U.S. 943 (1976) 8

Shanks v. Greenbriar Dodge, Inc., No. C75-1154 (N.D.Ga. 1976) *rev'd* 577 F.2d 296 (5th Cir. 1978) 12, 13, 21

Sioux County v. National Security Bank, 276 U.S. 238 (1928) 26

Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974) 4

Souife v. First National Bank of Commerce, 628 F.2d 480 (5th Cir. 1980), *pet. for reh. en banc pend.*.....15

Starks v. Orleans Motors, Inc., 372 F.Supp. 928 (E.D.La. 1974).....16

Stovall v. Denno, 388 U.S. 293 (1967).....26

Tehan v. United States ex rel. Shott, 382 U.S. 406 (1966) 26

Thomas v. Myers-Dickson Furniture Company, 479 F.2d 740 (5th Cir. 1973) 4

Travis v. Trust Company Bank, 621 F.2d 148 (5th Cir. 1980) 13, 14, 15

United States v. Schooner Peggy, 1 Cranch 103, 2 L.Ed. 49 (1801) 27

Valencia v. Anderson Bros. Ford, 617 F.2d 1278 (7th Cir. 1980) 23

White v. Arlen Realty and Development Corp., 540 F.2d 645 (4th Cir. 1975) 4

Statues and Rules

Page

Legal Services Corporation Act, 42 U.S.C Sec. 2996 *et seq.* 1

42 U.S.C. Sec. 2996(3) 2

Truth-in-Lending Act, 15 U.S.C. Sec. 1601 *et seq.* ..... *passim*

15 U.S.C. Sec. 1602 16

15 U.S.C. Sec. 1640(a) 4, 18

15 U.S.C. Sec. 1640(b) 19, 22

15 U.S.C. Sec. 1640(e) 26

15 U.S.C. Sec. 1640(f) 20

Truth in Lending Simplification and Reform Act, Pub.L. No. 96-221, Title VI, 94 Stat. 168 24

Rule 36.2, Rules of the U.S. Supreme Court 1

Regulation Z and Federal Reserve Board Interpretations

Regulation Z, 12 C.F.R. Part 226 ..... *passim*

12 C.F.R. Sec. 226.1(d) 20, 24

12 C.F.R. Sec. 226.2(gg) 10

Federal Reserve Board Public Information Letter No. 377 [1969-1974 Transfer Binder] Consumer Credit Guide (CCH) Par. 30,555 (July 22, 1970) 6, 10, 11, 12, 13, 17, 23, 24

Congressional Materials

HR Rep. No. 1040, 90th Cong., 1st Sess., N. 18, at 13, *reprinted in* (1968) U.S. Code Cong. & Ad. News 1962 16

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BRIEF OF INDIAN PUEBLO LEGAL SERVICES, INC. AS *AMICUS CURIAE*

Indian Pueblo Legal Services, Inc. respectfully submits this Brief as *Amicus Curiae* in support of the Respondents, filed upon the written consent of all parties pursuant to Rule 36.2 of the Rules of this Court.

INTEREST OF *AMICUS CURIAE*

Indian Pueblo Legal Services, Inc. (hereinafter "IPLS") is a non-profit New Mexico corporation funded by the Legal Services Corporation (hereinafter "LSC") pursuant to the LSC Act, 42 U.S.C. Sec. 2996 *et. seq.* LSC was established by Congress to "provide legal assistance to those who face an

economic barrier to adequate legal counsel . . . and [to] assist in improving opportunities for low-income persons . . ." 42 U.S.C. Sec. 2996(3).

IPLS has four offices in New Mexico and provides legal services to all of the Pueblo Indians of New Mexico. The Pueblos have retained their unique and ancient cultures throughout centuries of change around them. Pueblo Indians have had difficulty adjusting to changes, particularly in the area of consumer affairs. They have had many problems dealing effectively with unscrupulous sellers and creditors who find the historical bartering economy of the Pueblo Indians easy prey to high pressure sales and credit practices. Even in regard to those creditors who do not consciously seek to exploit the Pueblos, this rich heritage, a blessing in so many other contexts, places the Pueblos at a tremendous disadvantage as they grapple with the complexities and unfamiliarity of mainstream American culture.

IPLS serves in the role of consumer advocate, attempting to equalize to some extent the disparate bargaining position between Pueblo Indian and creditor. It is in this role that IPLS participates as *Amicus Curiae* in support of Respondents Olga Valencia and Miguel Gonzales.

To exist as an Indian in New Mexico, a state renowned for its lack of public transportation, a vehicle is a necessity both for travel to urban areas to purchase food and clothing and to gather wood to provide heat for homes. Indian people often finance their vehicles through national creditors such as Petitioner Ford Motor Credit Company and General Motors Ac-

ceptance Corporation. (It is these creditors which employ the assignment clause presented for review in the present lawsuit.)

The clients whom IPLS serves have no awareness that their creditors receive the returned or unearned insurance premiums which they have purchased for their vehicle. Only by enforcement of the requirements of the Truth-in-Lending Act and Regulation Z will Pueblo Indian people be given the opportunity to comparison shop for the credit they seek or to become aware of the extent of the obligations which they have incurred and to which they bind themselves.

ARGUMENT

SUMMARY OF ARGUMENT

The substantive issue before this Court is not addressed here by *Amicus*. Rather, this Brief discusses only the second question presented by Petitioners (hereinafter "Creditors") concerning whether the ruling on the merits should be applied fully retroactively or, as in *Cipriano v. Houma*, 395 U.S. 701 (1969), applied to all pending actions and to those which could be brought within the applicable one year statute of limitations.

The position of *Amicus* is that any judgment should be made fully retroactive. To permit creditors to avoid liability to consumers by prospective only application would be to subvert the Congressional intent of requiring full disclosure of the costs and terms of credit. Prospective only application would render totally ineffective and useless the private en-

forcement mechanism established by Congress to hold creditors who have violated the Act accountable to those consumers against whom a violation has occurred.[1]

The question before this Court is whether, under the Truth-in-Lending Act[2] (hereinafter "the Act") and Federal Reserve Board Regulation Z[3] (hereinafter "Regulation Z"), the assignment of returned or unearned premiums of physical damage insurance creates a security interest which must be disclosed. If, as argued by Respondents Olga Valencia and Miguel Gonzales (hereinafter "Consumers"), such an assignment does create a security interest which was improperly disclosed, then Creditors have violated the Act and Regulation and are subject to the damage provision therein.[4]

Creditors and *Amici Curiae* Consumer Banker's Association, General Motors Acceptance Corporation and the Na-

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1 15 U.S.C. Sec. 1640(a) created a force of "private attorneys general" charged with enforcing compliance with the requirements of the Act. See *McGowan v. King, Inc.*, 569 F.2d 845, 848 (5th Cir. 1978); *Murphy v. Household Finance Corp.*, 560 F.2d 206, 210 (6th Cir. 1977); *Hannon v. Security National Bank*, 537 F.2d 327, 328 (9th Cir. 1976); *White v. Arlen Realty and Development Corp.*, 540 F.2d 645, 649 (4th Cir. 1975); *Sosa v. Fite*, 498 F.2d 114, 121 (5th Cir. 1974); and *Thomas v. Myers-Dickson Furniture Company*, 479 F.2d 740, 748 (5th Cir. 1973).

2 15 U.S.C. Sec. 1601 *et seq.*

3 12 C.F.R. Part 226

4 15 U.S.C. Sec. 1640(a) provides that if any violation of the Act is found, a creditor is liable to the consumer for twice the finance charge but not less then $100 nor more than $1,000, plus attorneys fees and costs.

tional Consumer Finance Association (hereinafter "Bankers") argue that if Creditors are found by this Court to have violated the Act, the judgment of this Court should be applied prospectively only, except as to the Consumers herein.[5] If Creditors' and Bankers' position is accepted by this Court, the effect would be to deny to all persons against whom a violation has occurred the statutory damage award provided in the Act. The Congressional intent of private enforcement of the Act would be thwarted, thereby providing an incentive to creditors throughout the country to ignore the explicit advice of the staff of the Federal Reserve Board and instead to gamble that that advice will be rejected by the judiciary.

Creditors and Bankers cite and apply the three pronged test formulated by this Court in *Chevron Oil v. Huson*, 404 U.S. 97 (1971), to support their contention that a judgment adverse to them should be applied prospectively only. In actuality as discussed below, the *Chevron Oil* test, if applied, only reinforces Consumers' position that the decision of this Court should be given full retroactive effect.

Creditors asked the District Court to apply its holding adverse to them prospectively only in a separate Motion for Rehearing after judgment was entered. The burden was on Creditors to prove reliance and the separate elements necessary for prospective only application, yet Creditors produced absolutely no evidence in support of their position, and thus the record does not contain any facts relevant to this analy-

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[5] See Section III, p.34 of Brief of the Petitioners, and Section III, p.21 of Brief of Bankers.

sis. The *Chevron Oil* test nevertheless would hinge on the application of critical facts absent here: the reliance by Creditors on clear past precedent supporting their position and equitable considerations mitigating against full retroactive effect.

There has never existed clear, past precedent which supports Creditors' position on the merits and upon which they could have relied. As early as 1970, the rule that the right to receive returned insurance premiums must be disclosed as a security interest was enunciated by the staff of the Federal Reserve Board.[6] One year prior to the date of the credit transaction at issue here, the first decision of a federal district court addressing this very question was issued.[7] Not only did that decision sustain Consumers' position that the assignment is a security interest which must be disclosed, but Ford Credit itself was a party to that litigation.

By September 1977, when Consumers purchased their vehicle, there was a split among the three district courts which had decided the question. Still, Creditors did not avail themselves of the provisions of the Act and Regulation Z and request an interpretation from the Federal Reserve Board (hereinafter "FRB" or "Board") to resolve this question. As

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[6] FRB Public Information Letter No. 377 [1969-1974 Transfer Binder] Cons. Credit Guide (CCH) Par. 30,555, July 22, 1970. Letter No. 377 is printed in full in the Addendum of Legal Authorities, *infra*, at p. A-1.

[7] *Edmondson* v. *Allen-Russell Ford, Inc.*, No. C75-940A (N.D.Ga. August 27, 1976), *aff'd* 577 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951 (1979).

shown below, if they had done so, Creditors could have fully protected themselves from liability regardless of the position taken by the Board or that subsequently taken by the courts.

Past precedent has never clearly supported Creditors' position on the merits. Most important, however, is the fact that Creditors have never claimed, even in this Court, that they relied on any authority whatsoever.

I. IF THIS COURT FINDS THAT CREDITORS HAVE VIOLATED THE ACT AND REGULATION Z, THAT DECISION SHOULD BE GIVEN FULL RETROACTIVE EFFECT.

A. INTRODUCTION

In their Brief, Consumers argue that the *Chevron Oil* case is not applicable. *Amicus*, while concurring with the position taken by Consumers, will proceed on the assumption that this Court will consider the *Chevron Oil* standards.

In *Chevron Oil v. Huson, supra*, this Court synthesized the case law which had been evolving for over a century. Cases prior to *Chevron Oil* had discussed the merits and requirements of the exceptional circumstances for prospective only application of judicial decisions. *Chevron Oil* formulated a cohesive standard for determining when departure from the normal rule of retroactive application may be appropriate. Three separate factors were to be considered:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed . . . .

> Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." (Citations omitted).

404 U.S. at 106-07.

Bankers have suggested, without citation of any authority,[8] that the Court below improperly required that all three factors be satisfied before a judicial decision be applied prospectively only. The Court below was correct in its holding that prospective only application is the exception to the rule and that all three elements of *Chevron Oil* are to be fully satisfied to deny full retroactive effect of a judgment.[9] Cf. *Hanover Shoe* v. *United Shoe Mach. Corp.*, 392 U.S. 481, 496 (1968). The burden is on the party invoking the *Chevron Oil* doctrine to justify the limited application,[10] and thus creditors must assert and prove all necessary factors.

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[8] Section III(A), pp. 21-22, Brief of Bankers.

[9] See e.g. *Schaefer* v. *First National Bank of Lincolnwood*, 509 F.2d 1287, 1294 (7th Cir. 1975), *cert. den.* 425 U.S. 943 (1976); *Jordan* v. *Weaver*, 472, F.2d 985, 995 (7th Cir.) *rev'd on other grounds sub nom., Adeleman* v. *Jordan*, 415 U.S. 651 (1974).

[10] See *Jimenez* v. *Weinberger*, 523 F.2d 689, 704 (7th Cir. 1975), *cert. den.* 427 U.S. 912 (1976).

Creditors have failed to meet their burden of justifying the limited application.[11] As discussed below, under no factor set forth in *Chevron Oil* are Creditors entitled to prospective only application.

B. CREDITORS HAVE FAILED TO MEET THE *CHEVRON OIL* TEST.

1. A DECISION HERE IN FAVOR OF CONSUMERS WOULD NOT OVERRULE CLEAR PAST PRECEDENT, NOR IS IT AN ISSUE OF FIRST IMPRESSION THAT WAS NOT CLEARLY FORESHADOWED.

Creditors and Bankers argue that the decision below overruled clear past precedent and was not clearly foreshadowed by the state of the law prior to the lower court opinion. Clear expression in the Act and Regulation Z as well as the pronouncements of the FRB and district courts have put all creditors on notice as to the requirements of the law. This notice was given well before the Seventh Circuit ruled in the instant case.

In *Ford Motor Credit Company v. Milhollin*, 444 U.S. 555 (1980), this Court addressed the issue of what weight is to be given pronouncements of the Board. If there is clear expression in the Act or Regulation, the pronouncements of the Board need not be consulted; but if an interstitial gap does

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[11] The Eigth Circuit has, in addition to the Seventh Circuit in the decision below, also ruled that Creditors can meet none of the *Chevron Oil* factors in the case of their defective disclosure of the security interest in insurance premium refunds. *Murphy v. Ford Motor Credit Co.*, 629 F.2d 556, 561 (8th Cir. 1980).

exist, the Board's authoritive statements are to be given deference. The question before the Court in this case is directly addressed by Regulation Z in its definition of "security" and "security interest" contained in 12 C.F.R. Sec. 226.2(gg). A reading of Regulation Z yields the inescapable conclusion that the assignment is a security interest since it secures payment or performance of the contractual obligations. In fact, every court considering the issue which has analyzed the Regulation Z definition in reaching its opinion has found the existence of a security interest, and those courts which have not required disclosure have reached that conclusion on bases other than that the assignment did not create a security interest as defined.[12]

If the clear language of the definition were not sufficient to "foreshadow" that result and if any question whatsoever remained after Regulation Z was promulgated, the FRB staff itself on July 22, 1970, explicitly stated in Letter No. 377, *supra*, that the right to receive unearned insurance premiums and apply them to a loan balance is a security interest which must be disclosed. The situation described in Letter No. 377

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12 *James* v. *Ford Motor Credit Co.*, Civ. No. 78-1806 (10th Cir. 1980), *reh. denied* (10th Cir. 1980), *petition for cert. filed* 49 U.S.L.W. 3333 (U.S. Oct. 20, 1980) (No. 80-640), and *Rounds* v. *Community National Bank in Monmouth*, 454 F.Supp. 883 (S.D.Ill. 1978), have reached independent decisions that the assignment need not be disclosed. *James* did not even analyze the Act or Regulation Z, basing its decision on the recently enacted and inapplicable Truth-in-Lending Simplification Act, and *Rounds* failed to note that Regulation Z addressed the question that the *Rounds* court was attempting to answer.

is directly analogous in all relevant parts to the present situation: The consumer purchases an insurance policy (life insurance in the letter, physical damage insurance in the instant case) in conjunction with the loan, the creditor being designated as owner or assignee of the policy during the term of the loan; in the event of the consumer's default, the creditor has the right to cancel the insurance and receive the refunded premiums; and the creditor has the right and discretion to apply these refunded premiums to the unpaid balance. It is irrelevant that Letter No. 377 deals with life insurance or that the creditor "owns" the insurance policy. What is important is that the creditor, through the assignment or ownership, receives a benefit that helps to secure payment of the underlying obligation.

Creditors and Bankers do not mention the precedential nature of Letter 377 in discussing whether this Court's decision is to be retroactively applied. Yet it is this Letter as well as case authority which yields the conclusion that this is not an issue of first impression and that the Seventh Circuit's opinion was clearly foreshadowed well before the date of the contract between Consumers and Creditors. If the Act and Regulation were not clear enough, Creditors had notice as early as 1970 that the interest was to be disclosed.

Finally, Ford Motor Credit Company is personally in no position to now claim surprise at the conclusion that this assignment is a security interest. In 1976, in the District Court proceedings in *Edmondson v. Allen-Russell Ford, Inc., supra*, Ford Credit admitted that this assignment provision created a

security interest.[13] Ford Credit should not be allowed to deny knowledge of that which it once admitted. If that admission could have been made to the court, then Ford Credit should have been able to admit this to itself and make the necessary improvements in its form disclosure statement.

Since as early as 1970 Creditors have had notice that the assignment clause at issue creates a security interest by virtue of the Regulation Z definition itself and particularly by FRB Letter No. 377. In addition, Ford Motor Credit Company formally and personally recognized this conclusion in 1976. Since that time, the overwhelming weight of judicial authority has continued to reaffirm that judgment. Creditors can show no past precedent on which they have in good faith relied; and rather than deciding "an issue of first impression whose resolution was not clearly foreshadowed," one can only conclude to the contrary that existing authority mandates affirmance of the decision below.

2. CREDITORS HAVE FAILED TO DEMONSTRATE RELIANCE ON CLEAR PAST PRECEDENT.

At the time of the instant transaction on September 30, 1977, there was no clear past precedent supporting Creditors' position on which they could have relied, as discussed in the

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13 See *Shanks* v. *Greenbriar Dodge, Inc.*, No. C75-1154 (N.D.Ga. 1976), Withdrawal of Recommendation, of October 27, 1976 and Magistrate's Report and Recommendation, of December 10, 1976.

preceding section.[14] Reliance requires knowledge of the fact relied upon.[15] The record here is silent as to whether Creditors even knew in 1977 of the split in the district courts. However, it is clear that Ford Credit knew of the authority contrary to its position since it was a party to the *Edmondson* case. Certainly Ford Credit must be charged with knowledge of Letter No. 377 unless it failed to exercise minimum good faith efforts to apprise itself of the published Public Information Letters of the FRB.[16]

Creditors have referred to *McDaniel* v. *Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978), as an example of proper prospective only application of a decision under the Act.[17] In *McDaniel*, the Fifth Circuit, sitting *en banc*, specifically

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[14] The state of the law then was a split among FRB Letter No. 377 and three District Court decisions. *Edmondson* v. *Allen-Russell Ford, Inc.*, *supra*, *Gennuso* v. *Commercial Bank and Trust Co.*, 425 F.Supp. 461 (W.D.Pa. 1976) *rev'd* 566 F.2d 437 (3rd Cir. 1977); and *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D.Ga. 1976), *rev'd* 577 F.2d 296 (5th Cir. 1978). Surely, Creditors can find no *clear* precedent for its position from those authorities, and in fact by virtue of a pronouncement by the staff of the Federal Reserve Board, the weight of authority at that time in fact required disclosure of the assignment clause. See *Ford Motor Credit Company* v. *Milhollin*, *supra*.

[15] See *Travis* v. *Trust Company Bank*, 621 F.2d 148 (5th Cir. 1980).

[16] See *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 879, fn. 13 (7th Cir. 1976); and *Hillers* v. *Local Federal Savings and Loan Association*, 204 Okla. 615, 618, 232 P.2d 626, 630 (1951).

[17] Brief of Creditors, p. 43.

overruled a prior panel decision of that Circuit which had not required a certain disclosure. *McDaniel*, in ordering conformance with an FRB Staff Interpretation, reversed the prior opinion.

McDaniel, however, is not the only Fifth Circuit pronouncement concerning prospective only application of a Truth-in-Lending Act decision. Creditors and Bankers omit from their Briefs any reference to the later Fifth Circuit case of *Travis v. Trust Company Bank, supra.* There, the Fifth Circuit refused to apply an earlier Truth-in-Lending decision prospectively only, reasoning that the sole district court decision, the creditor's "so-called 'clear past precedent' " which was later overruled, was issued months after the credit transaction, and thus the creditor could not and did not rely on it. 621 F.2d at 150.

The particular circumstances in *McDaniel* present a compelling reason to order prospective only application of that decision within that Circuit. But *McDaniel* is inapposite to this case since no precedent from a Circuit Court of Appeals ever favored creditors until just last June when the Tenth Circuit created the present split in the Circuits on this issue.[18] Even *Travis*, which does not support Creditors, is dis-

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[18] *James v. Ford Motor Credit Company, supra.* Five Circuits have ruled on this issue, and of the fifteen judges who sat on those panels, only two have sustained Creditors' position. Those two judges, however, formed the majority of the split opinion in *James*. Since June 1980, six judges from two separate Circuit Court opinions have examined this issue and all six have specifically rejected the *James* majority and have ruled that the assignment creates a security interest which (Cont.)

tinguishable from the present case since in *Travis* there had been a time when the sole precedent on the issue had favored the creditor position. In this case, there has never existed "clear past precedent" to support Creditors, and Creditors in any event do not claim and have not shown that they relied on any authority whatsoever.

3. CREDITORS HAVE FAILED TO DEMONSTRATE THAT FULL RETROACTIVE APPLICATION WILL IMPEDE THE OPERATION OF THE ACT.

The second *Chevron Oil* factor is that a court considering prospective only application must weigh the merits and demerits of each case by determining whether the purpose of the underlying rule would benefit from a limited application. This burden must fall on Creditors, the party seeking the exceptional application.[19]

The Truth-in-Lending Act was enacted as a result of Congressional recognition that consumers were in a disparate bargaining position with creditors. Information important as a tool in shopping for credit and understanding one's obliga-

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[18] (Cont. from page 14)
must be disclosed. *Murphy v. Ford Motor Credit Company, supra,* and *Souife v. First National Bank of Commerce,* 628 F.2d 480 (5th Cir. 1980), *pet. for reh. en banc pend.*

[19] See *Murphy v. Ford Motor Credit Company, supra,* 629 F.2d at 561.

tions was not being disclosed by creditors.[20] The Act sought to correct the disparity by requiring that certain information be disclosed to the consumer in a certain manner. Importantly, consumers were encouraged to enforce the Act both as a method of receiving compensation for their own damages and as a method of forcing creditor compliance with the dictates of the Act. The effectiveness of the Act hinges on private enforcement.

Both Creditors and Bankers argue that retroactive application will not further the purposes of the Act. As stated previously, the necessity of making the disclosure which is the subject of this case had been foreshadowed, yet Creditors ignored this requirement and refused to make that disclosure. Creditors were not deterred from making their faulty disclosures by either the Federal Reserve Board's opinion in 1970 or later opinions of circuit courts. Prospective only application would in fact serve as an incentive to creditors to not comply with their obligations under the Act.[21] Only by ap-

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[20] The Act was passed by Congress in 1968 in response to its determination that "the American consumer [should]be given the information he needs to compare the cost of credit and to make the best informed decision on the use of credit." *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 364 (1973), quoting HR Rep. No. 1040, 90th Cong., 1st Sess., N. 18, at 13, *reprinted in* (1968) U.S. Code Cong. & Ad. News 1962; see also the Act, 15 U.S.C. Sec. 1602.

[21] The remedial purpose of the Act was recognized by this Court in *Mourning v. Family Publications Service, Inc., supra*, 411 U.S. at 364-365 and by Congress, 15 U.S.C. Sec. 1602. The position urged by Creditors to eliminate the statutory remedy is antithetical to this purpose. See *Starks v. Orleans Motors, Inc.*, 372 F.Supp. 928, 931-932 (E.D.La. 1974) ("Where (Cont.)

plying this Court's decision retroactively will these and other creditors be deterred in the future from ignoring the pronouncements of the courts and administrative agency.

The role of the Federal Reserve Board within the entire statutory scheme was intended to be and has become central.[22] Just last term, this Court confirmed that role in *Ford Motor Credit Company* v. *Milhollin, supra,* in which it ordered deference to FRB staff opinions "[u]nless demonstrably irrational." 444 U.S. at 565.[23] To now allow Creditors to disregard those opinions and to escape the consequences of the private enforcement mechanism would signal the consumer credit industry that the Act and the Federal Reserve Board, not to mention last term's pronouncement by this Court, are to be ignored.

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[21] (Contd. from page 16)
the nature of an act is remedial, as here, it should be construed liberally in an attempt to provide the remedy, not avoid it.")

[22] See 15 U.S.C. Sec. 1604, and *Mourning* v. *Family Publications Service, Inc., supra.*

[23] The deference in *Milhollin* was to an official staff opinion. Letter No. 377 is an unofficial opinion. This Court made no distinction in its holding between the two types of opinions, and the one Circuit Court of Appeals to address the issue specifically applied it to unofficial opinions. *Montoya* v. *Postal Credit Union,* 630 F.2d 745, 747 (10th Cir. 1980). Indeed, the rationale underlying the *Milhollin* decision - uniformity of disclosure and staff expertise - is equally applicable to official as well as unofficial opinions.

The deterrent aspect of the Act's private enforcement mechanism is the most important non-disclosure provision of the Act. The Congressional intent would be thwarted if this deterrent is diluted by a limited application of a favorable judgment by this Court. The conduct of Creditors is proof of this proposition.

Bankers further argue that this Court's decision should be applied prospectively only because the damages provided are not corrective but "prophylactic" in nature. This new "element" introduced by Bankers is not considered by *Chevron Oil*, but had it been, Bankers' position would still be incorrect. No showing of actual damages under the Act is necessary to trigger the application of the damages clause.[24] Proving actual damages was not required by Congress for several reasons: Actual damages were inherent in a faulty disclosure, historically actual damages were nearly impossible to prove, and without such provision, there would be no effective enforcement of the Act. Thus, the damage provision contained in the Act does remedy the wrongs of the creditor and redress the injuries suffered by the consumer.[25] A favorable decision by this Court must be made fully retroactive to insure enforcement of the underlying purposes of the Act.

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[24] 15 U.S.C. Sec. 1640(a).

[25] See footnote 21, *supra*.

4. THE EQUITIES INVOLVED WEIGH IN FAVOR OF FULL RETROACTIVE APPLICATION.

The final factor to be considered under the *Chevron Oil* analysis is whether the equities involved would support prospective only application of this Court's judgment. As stated earlier, all three *Chevron Oil* factors must be satisfied to support limited application of a judgment. Since neither of the other two factors have been met by Creditors or Bankers, it should not be necessary to consider the equities. However, based upon the equitable considerations alone, this Court should not apply its decision prospectively only.

a. CONGRESS AND THE BOARD HAVE PROVIDED EQUITABLE METHODS FOR CREDITOR COMPLIANCE.

Congress and the Board have recognized implicitly that a creditor might have difficulty determining in advance which disclosures should be made under the Truth-in-Lending Act. Several methods which could have been employed by Creditors to insure compliance were provided as part of the statutory scheme, but none was used.

15 U.S.C. Sec. 1640(b) provides that any creditor who becomes aware that its disclosures violate the Act can correct those disclosures by notifying its debtor in writing of the mistake within 15 days and thereby can avoid any liability.[26]

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[26] 15 U.S.C. Sec. 1640(b) states:

(b) A creditor has no liability under this section for any failure to comply with any requirement im-

(Cont.)

Creditors here could have availed themselves of this measure and would have been fully protected had they chosen to so notify their customers. Rather, Creditors knowingly gambled that they would ultimately be proved correct, knowing full well the risk they were taking. Creditors would now have Consumers absorb the cost of the Creditors' conscious gamble.

Also provided as a method for a creditor to cross-check its disclosures is the opportunity, if a creditor has a question, to request an interpretation from the Board.[27] The Board's interpretation, when complied with by the creditor, would then form the basis for the defense set forth in 15 U.S.C. Sec. 1640(f)[28] as well as for the protection provided by *Ford*

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[26] (Cont. from page 19)
posed under this part or part E of this subchapter if within fifteen days after discovering an error, and prior to the institution of an action under this section or the receipt of written notice of the error, the creditor notifies the person concerned of the error and makes whatever adjustments in the appropriate account are necessary to insure that the person will not be required to pay a charge in excess of the amount or percentage rate actually disclosed.

[27] 12 C.F.R. Sec. 226.1(d).

[28] 15 U.S.C. Sec. 1640(f) states:
(f) No provision of this section or section 1611 of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board
(Cont.)

Motor Credit Company v. *Milhollin, supra.* A creditor who relies in good faith on such a pronouncement of the Board or its staff is not liable for a violation subsequently established in spite of the pronouncement.

Creditors here have never requested such an interpretation. On July 31, 1980, a creditors' group did make such a request, but the request came *after* the decision of four Circuit Courts of Appeals in *Edmondson, Shanks, Gennuso,* and *James,* [29] and even after the Petition for Certiorari in this case had been filed with this Court. An interpretation requested this late in the development of the present issue could not possibly support a claim of good faith.

The availability of the procedure to request an FRB interpretation belies the argument made by Bankers that prospective only application is appropriate because a creditor has

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[28] (Cont. from page 20)
may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

[29] *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978) *cert. denied*, 441 U.S. 951 (1979); *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978); *Gennuso* v. *Commercial Bank and Trust Co.*, 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd*, 566 F.2d 437 (3rd Cir. 1977); and *James* v. *Ford Motor Credit Co.*, Civ. No. 78-1806 (10th Cir.), *reh. denied* (10th Cir. 1980), *petition for cert. filed*, 49 U.S.L.W. 3333 (U.S. Oct. 20, 1980) (No. 80-640).

only two choices once it suspects a violation of the Act: "(a) to accede to the position urged by his opponents or (b) to litigate and face the risk of truly staggering penalties if unsuccessful at the end of the day."[30] Bankers urge that limited application allows "creditors to present their positions to the courts without intimidation."[31] To the contrary, the third option of seeking an interpretation eliminates any risk and does so without requiring an abandonment of the creditor's right to continue to litigate in the courts.[32]

Creditors have chosen not to take advantage of the methods specifically provided by Congress and the Board to relieve them of liability and risk, and now are in no position to complain that their gamble lost.

b. CREDITORS' CONSCIOUS BUSINESS DECISION WILL NOT CAUSE UNDUE HARDSHIP

After Creditors learned of the various circuit court opinions on this issue, they continued to employ the same form contract with the same clause that had been found to violate

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30 Brief of Bankers, p. 28.

31 *Id.*

32 If the FRB interpretation is unfavorable, the creditor avoids "staggering penalties" by correcting the error pursuant to 15 U.S.C. Sec. 1640(b). As to the customer who has brought the error to the creditor's attention, the right to correct is generally not available, but the liability owing to him is modest and fully consistent with the Congressional intent that consumers be the moving force in assuring compliance.

the Act.[33] The Court below termed this failure to comply with the circuit court opinions a "conscious business decision," stating in a footnote as follows:

> As plaintiffs point out, defendants are not in an ideal position to claim that retroactive application of our ruling will cause undue hardship. Ford Motor Credit was a defendant in the *Edmondson* litigation. Ford learned on July 28, 1978, when *Edmondson* was decided by the Fifth Circuit, that at least one court of appeals considered its failure to disclose an assignment of unearned insurance premiums as a security interest a violation of the TILA. Despite this decision, Ford continued to use, in other circuits, a form contract which had been held to violate the Act in the Fifth Circuit. Ford was certainly entitled to do so since *Edmondson* was not the law in other circuits. However, in doing so Ford was gambling that its view of the law would prevail over the *Edmondson* view in subsequent suits. The fact that Ford now faces the consequences of losing its conscious gamble hardly presents a case of inequitable hardship .... The *Chevron Oil* doctrine is not directed at insulation of litigants from the consequences of their conscious business decisions; rather, its purpose is to avoid the hardship which can result from retroactive application of the decisions which represent sudden, unexpected shifts in the law. This is not such a case.

617 F.2d at 1290, n. 16.

Not only did Creditors fail to conform to decisions from United States Circuit Courts of Appeals, but they also consciously failed to heed the advice of FRB Letter No. 377. If Creditors honestly believed that the difference between life

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[33] In New Mexico, for example, Ford Motor Credit Company continued to use the form disclosure statement with the identical assignment clause on the reverse side until the summer of 1979.

insurance and property insurance or between ownership and assignment (the difference between Letter No. 377 and the instant case) is of any moment, then they should have requested an interpretation in 1970 pursuant to Sec. 226.1(d) of Regulation Z at least on that narrow question; but they did not. Now Creditors are in the anomalous and contradictory position of claiming undue hardship when they seek to avoid the liability which they have consciously incurred.

c. THE TRUTH IN LENDING SIMPLIFICATION ACT DOES NOT ESTABLISH CREDITORS' GOOD FAITH

Creditors and Bankers argue that the Truth in Lending Simplification and Reform Act[34] (hereinafter "TIL Simplification") has vindicated their position and thus mitigates in favor of prospective only application.

TIL Simplification does not affect the assignment in question in any manner whatsoever: Congress did not intend to explain or clarify the existing law but to alter it.[35] However, if the Court finds TIL Simplification relevant, as pointed out by Creditors and Bankers, the new law is not effective until 1982. Thus, Creditors cannot point to TIL Simplification in an attempt to establish good faith. Good faith is a state of mind which must exist when the position is taken. Creditor's contract with Consumers was written in 1977, and TIL Simpli-

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[34] Truth in Lending Simplification and Reform Act, Pub.L. No. 96-221, Title VI, 94 Stat. 168.

[35] See Petition for Writ of Certiorari filed in *James v. Ford Motor Credit Co.*, *supra*, Sec. III, p. 19.

fication was not enacted until 1980 and does not become effective until 1982. Creditors cannot now point to the new law in an attempt to relieve themselves from their liability.

d. SUMMARY

Based on a consideration of all equities involved, Creditors cannot now claim that they should be granted prospective only application of the judgment of this Court. Creditors had several opportunities to correct their disclosures but rather chose at each stage to gamble. They realized that they were exposing themselves to liability. Yet now they would have this Court grant them the benefit of their gamble, to the detriment of the numerous consumers involved. Creditors can show no equities in their favor on this issue and, in those instances where they ignored actual notice that their disclosure statement was defective, may in fact have acted affirmatively in bad faith.

C. IF THIS COURT FINDS A VIOLATION OF THE ACT AND DETERMINES THAT ITS JUDGMENT IS TO BE APPLIED PROSPECTIVELY ONLY, THAT JUDGMENT SHOULD BE MADE APPLICABLE TO ALL PRESENTLY PENDING LAWSUITS ON THIS ISSUE

If this Court does find that Creditors have violated the Act but, contrary to the above, determines that the exception of prospective only application is appropriate, the Court should also make its decision applicable to all cases alleging this violation which are pending on the date of the Court's decision,

or which could be brought within the applicable one year statute of limitations under the Act.[36]

There are several separate and distinct approaches to the grant of prospective relief which have been taken by this Court: (1) prospective application allowing retroactive application only to the parties before the Court:[37] (2) prospective application generally but granting retroactive application to the parties and to all pending actions;[38] (3) prospective application generally but granting retroactive application to the parties, to all pending actions and to all actions which could be brought within the applicable statute of limitations;[39] and (4) application to all pending cases including cases in which

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[36] See 15 U.S.C. Sec. 1640(e): All affirmative actions under the Act must be brought within one year after the date of the transaction.

[37] *Foster* v. *California*, 394 U.S. 440 (1969); *Desist* v. *United States*, 394 U.S. 244 (1969); *DeStefano* v. *Woods*, 392 U.S. 631 (1968); and *Stovall* v. *Denno*, 388 U.S. 293 (1967).

[38] *Hamling* v. *United States*, 418 U.S. 87 *reh. denied* 419 U.S. 885 (1974); *Miller* v. *California*, 413 U.S. 15 *reh. denied* 414 U.S. 881 (1973); *Angelet* v. *Fay*, 381 U.S. 654 (1965); *Linkletter* v. *Walker*, 381 U.S. 618 (1965); *Oklahoma Packing Co.* v. *Oklahoma Gas and Electric Co.*, 309 U.S. 4 (1939); *Sioux County* v. *National Security Bank*, 276 U.S. 238 (1928); and *Kibbe* v. *Ditto*, 93 U.S. 674 (1876). See also *Tehan* v. *United States ex rel. Shott*, 382 U.S. 406 (1966) at fn. 3, p. 409, discussing the application of *Griffin* v. *California*, 380 U.S. 609 (1965), to pending cases such as *O'Connor* v. *Ohio*, 382 U.S. 286 (1965).

[39] *Cipriano* v. *Houma*, 395 U.S. 701, 706 (1969).

final judgments have been entered.[40] Most of those cases concern criminal law, yet this Court has recognized that the approaches are equally applicable to civil actions.[41]

As early as 1801 in *United States* v. *Schooner Peggy, supra,* as cited in *Linkletter* v. *Walker, supra,* [42] it was recognized that retroactive application to all presently pending cases was an acceptable method for the implementation of a judicial decision. In *Cipriano* v. *Houma,* citing *Linkletter,* the judgment was applied to all presently pending cases and to those which could still be brought within the applicable statute of limitations. By such application, gross inequities to other litigants would be avoided.

Creditors ask this Court to apply a decision favorable to Consumers prospectively only except as to these Plaintiffs.[43] Bankers suggest an even more unusual approach: They suggest prospective only application in this case, but that the Court

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40 *Amicus* does not suggest that this application to final judgments be made in the present case. In criminal cases collateral attack through a Writ of Habeas Corpus exists as a remedy for implementing new judicial decisions while no such possibility exists in a civil action. For a list of cases employing this method of prospective application, see generally Annotation, 22 L.Ed. 2d 821 at 843, Sec. 5(d).

41 See *Linkletter* v. *Walker, supra,* 381 U.S. at 627 (1965), citing *United States* v. *Schooner Peggy,* 1 Cranch 103, 2 L.Ed. 49 (1801); *James* v. *United States,* 366 U.S. 213 (1961); and *Chicot County Drainage Dist.* v. *Baxter State Bank,* 308 U.S. 371 (1940).

42 381 U.S. at 627.

43 Brief of the Petitioners, p. 35.

should rewrite the Act to allow retroactive application in cases of "actual harm."[44] Other cases are pending in the courts of this country on the identical issue presented here, including a case in which a Petition for Writ of Certiorari has been filed with this Court.[45] Only because judicial machinery in different United States District and Circuit Courts operates at different rates is this particular case before the Court rather than any of the other cases. Yet Creditors arbitrarily only want Consumers in the present case to benefit from a favorable decision. Other consumers across the country who have sought or could still seek to enforce their rights under the Truth-in-Lending Act would be denied the benefit of a decision which vindicates their claim to relief as mandated by the Congressional policy of private enforcement.

The unfairness of such an application is obvious. Creditors and Bankers are not concerned with fair play and equity unless it would serve to relieve them of liability. No evidence has been presented and no argument made that would justify application of this Court's judgment only to Ms. Valencia and Mr. Gonzales to the detriment of all other similarly situated consumers whose cases are pending or could properly be pending in the courts of this country.

Amicus urges that even if the judgment of this Court is applied prospectively only, its application be made retroac-

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[44] Brief of Bankers, p. 26.

[45] *James v. Ford Motor Credit Co., supra.*

tive to these Consumers, to all other consumers whose cases are presently pending, and to those consumers whose cases could still be brought within the applicable statute of limitations.

II. CONCLUSION

Creditors and Bankers argue for prospective only application of a judgment by this Court which finds that Creditors have violated the Truth-in-Lending Act. Under the *Chevron Oil* test, Creditors have satisfied none of the three factors which are required for prospective only application, and the judgment of this Court must be given full retroactive application as discussed herein.

Amicus respectfully urges this Court to grant full retroactive application of its judgment or, in the alternative, to hold its judgment applicable to the parties in the present case, to all other cases now pending in the courts of this country, and to those cases which could still be brought within the applicable statute of limitations.

Respectfully submitted,

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February 25, 1981

FEDERAL RESERVE BOARD
PUBLIC INFORMATION LETTER NO. 377

Sec.	226.4(a) 226.8(b) 226.8(c)	Proceeds of loan used to purchase insurance

July 22, 1970

As we understand the proposed plan, your client proposes to place literature in its loan offices concerning insurance to be sold by a company unrelated to your client. Applications for a single premium lifetime accidental death and dismemberment policy are available in each office and if a customer desires to purchase such a policy with the proceeds of his loan, a check will be sent directly to the company from your client in payment of the premium. While your client will not require the purchase of this insurance and the proceeds of the policy would in no circumstances be used to pay any portion of an unpaid balance of the loan, your client would be designated as the owner of the policy during the term of the loan. In the event of the customer's default, your client would have the right to cancel the policy and apply any premium refund to the unpaid balance of the loan.

Under the circumstances, we think it would be appropriate to disclose the loan company's ownership of the policy as a type of "security interest" under Sec. 226.8(b)(5) and disclosure need not be made under Sec. 226.4(a)(5). The amount of the premium would not be included in the "finance charge" nor would it be disclosed as an "other charge."

Tynan Smith
Assistant Director

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Petitioners,

v.

OLGA VALENCIA AND MIGUEL GONZALEZ,

Respondents.

On A Writ Of Certiorari To The United States Court of Appeals For The Seventh Circuit

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BRIEF OF THE UAW LEGAL SERVICES PLAN AS *AMICUS CURIAE*

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	5
I. THE RIGHT TO UNEARNED INSURANCE PREMIUMS IS A SECURITY INTEREST AND MUST THEREFORE BE DISCLOSED AS SUCH	5
A. Any Security Interest Must Be Disclosed Under The Act And Regulation Z	5
B. The Circuits Have Found And Petitioner Concedes That The Right To Unearned Insurance Premiums Is A Security Interest	5
C. The Only Position Of The Federal Reserve Board Entitled To Any Deference Is Its Consistent View That The Right To Unearned Insurance Premiums Is A Security Interest Under The Act	7
II. EVEN IF THE ACT AND REGULATION Z REQUIRED THAT ONLY SUBSTANTIAL SECURITY INTERESTS NEED BE DISCLOSED AND ONLY WHEN THIS COULD BE DONE WITHOUT CONFUSING CONSUMERS, THE RIGHT TO UNEARNED INSURANCE PREMIUMS WOULD HAVE TO BE DISCLOSED	11
A. The Right To Unearned Insurance Premiums Is A Substantial Interest	11
B. Disclosure Of The Security Interest In Unearned Insurance Premiums Need Not Result In Any Confusion To Consumers	15
CONCLUSION	19

TABLE OF AUTHORITIES

Cases: Page

Edmundson v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) 6, 13

Ford Motor Credit Co. v. *Milhollin*, 444 U.S. 555 (1980) 7, 10, 15

Gennuso v. *Commercial Bank & Trust Co.*, 544 F.2d 437 (3rd Cir. 1977) 6

James v. *Ford Motor Credit Co.*, —— F.2d —— (10th Cir. 1980) 5-6

Murphy v. *Ford Motor Credit Co.*, 629 F.2d 556 (8th Cir. 1980) 5, 6

Souife v. *First National Bank of Commerce*, 628 F.2d 480 (5th Cir. 1980) 5-6, 12

Valencia v. *Anderson Bros. Ford*, 617 F.2d 1278 (7th Cir. 1980) 5, 6, 6-7, 8, 12

Statutes and Regulations:

15 U.S.C. § 1637(a)(7) 14

15 U.S.C. § 1638(a)(10) 5, 14, 19

15 U.S.C. § 1639(a)(8) 14

15 U.S.C. § 1640(f) 7

P.L. 96-221, 94 Stat. 132 (1980) 9

12 C.F.R. § 226.1(d) (1980) 10

12 C.F.R. § 226.2(gg) (1980) 5, 6-7, 19

12 C.F.R. § 226.8(b)(5) (1980) 8

Miscellaneous:

American Council of Life Insurance, *Life Insurance Fact Book* (1969) 12

American Council of Life Insurance, *Life Insurance Fact Book* (1979) 13

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TABLE OF AUTHORITIES—Continued

Page

Federal Reserve Board, Comments Re Proposed Official Staff Interpretation FC-1073, Public Comment No. 53 (1980) 14
R. Flesch, *How to Write Plain English* (1979) 17
R. Flesch, *A New Readability Yardstick*, 32 J. Applied Psych. 221 (1948) 17, 18
FRB Public Position Letter No. 377, [1969-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 30,555 (July 22, 1970) 7, 8
FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 31,763 (November 23, 1977) 8-9
J. Landers, *Determining the Finance Charge Under the Truth-in-Lending Act*, 1 Am. Bar Foundation Research J. 45 (1977) 12-13
Proposed Official Staff Interpretation, FC-0173 (September 18, 1980) 9, 10
Proposed Official Staff Interpretation FC-0173, Deferral of Final Action, 45 Fed. Reg. 84074 (December 22, 1980) 9
Revised Truth in Lending Regulation Z, § 226.2 (bb) CCH Cons. Credit Guide Report No. 304 (May 5, 1980) 9
Revised Truth in Lending Regulation Z, § 226.2 CCH Cons. Credit Guide Report No. 319 (December 4, 1980) 10
J. Sheffey, *Credit Life and Disability Insurance Disclosures Under Truth in Lending: The Triumph of Form Over Substance*, 8 Fla. St. U. L. Rev. 463 (1980) 13
State of Michigan, Department of Licensing and Regulation, Insurance Bureau Internal Memoranda (1980) 11-12

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Respondents.

On A Writ Of Certiorari To The United States Court of Appeals For The Seventh Circuit

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BRIEF OF THE UAW LEGAL SERVICES PLAN AS *AMICUS CURIAE*

The UAW Legal Services Plan respectfully submits this Brief as *amicus curiae* in support of the Respondents, filed upon the written consent of all parties in accordance with Rule 36.2 of the Rules of this Court.

INTEREST OF *AMICUS CURIAE*

The UAW Legal Services Plan ("Plan") is a national prepaid legal services program for employees and retirees of the Chrysler Corporation. Staff offices are located in Michigan, Indiana, Missouri, Ohio, Delaware, New York

and Illinois. Legal services in areas not covered by staff offices are provided by a combination of referrals to private attorneys, contracts with private attorneys and insurance plans.

Since opening in November, 1978 the Plan has handled over 43,000 cases, almost 11,000 of which were categorized as consumer cases. A significant number of the consumer cases involve consumer credit transactions subject to the Truth in Lending Act.

Virtually every installment sales contract entered into by the Plan's clients includes the financing of insurance premiums either for property damage coverage, credit life insurance or credit disability insurance. These premiums involve hundreds of dollars in each contract. The disclosure of the security interest in unearned premiums is important to participants of the Plan and, presumably, to consumers in general.

SUMMARY OF ARGUMENT

The Truth in Lending Act ("TILA" or "Act") and Regulation Z mandate that all "security interests" must be disclosed on the front of a retail installment contract together with other required TILA disclosures. In the contract in question, Petitioner has a right to apply any unearned insurance premiums to the outstanding debt but has failed to include that right as part of its TILA disclosures.

The issue is whether the interest in unearned insurance premiums is a "security interest" under the Act and Regulation Z. If so, the failure to disclose the interest as such violated the Act.

Petitioner does not seriously dispute that the right to unearned insurance premiums is a "security interest". The decisions of each of the circuit courts of appeal have found the right to unearned insurance premiums is a

security interest. The Federal Reserve Board has consistently viewed the right to unearned insurance premiums as a security interest under the Act. Even the proposed Official Staff Interpretation of the Board, on which action has been deferred pending this Court's decision, recognizes that the right to unearned insurance premiums is a security interest albeit an "incidental interest" under the Act. This consistent view of the Federal Reserve Board is entitled to deference.

Assuming *arguendo* that the Act and Regulation Z do not require disclosure of all security interests but only "substantial" security interests and only when disclosure would not confuse consumers, the security interest here would still have to be disclosed.

The right to the unearned insurance premiums is a substantial economic right. It is the experience of *Amicus* that the amount of unearned insurance premiums in question can be as great as $1,600.00 in a typical automobile retail installment contract. Nationwide, in 1978, over 83,000,000 people were covered by credit life insurance, one of the types of insurance reflected in the $1,600.00 figure. The total amount of insurance written was over $163,000,000,000.00.

The right to unearned premiums is also of practical significance. Absent the creditor's security interest, the consumer could cancel the insurance and apply the refunded premiums as necessary. The unearned premiums could be available to stop a mortgage foreclosure or even a default on the existing loan. For creditors the practical significance arises from the ease with which the unearned premiums are obtained in the event of default. The creditor can obtain the money without litigation, notice to the debtor, or the cumbersome method of repossession and resale as in the case of other collateral. In light of these economic and practical considerations, the

right to unearned insurance premiums is a substantial right. To characterize it in any other way ignores the reality of consumer credit transactions.

Nor would the disclosure of that security interest have to detract from the consumer's understanding of the typical installment contract. Less disclosure is not necessarily better disclosure. The concept often referred to as "information overload" does not mean that more disclosure is bad any more than it means that less disclosure is necessarily good. The ability to understand information actually increases as the information load increases, until an optimum level is reached.

Rather "readibility", or the method of presentation, is the more important factor in a consumer's understanding of retail installment contracts. Studies have shown that consumers better understand contracts drafted for "readability" than those containing fewer disclosures yet drafted in a typical "legal" style. "Readability" is within the control of the drafter. Thus creditors' complaints that disclosure of their interest in unearned premiums would frustrate the purpose of the Act assumes that creditors will use needlessly complicated and wordy forms. *Clearer disclosure is required, not less disclosure.*

In considering this issue this Court must look to the plain meaning of TILA and Regulation Z. The Third, Fifth, Seventh and Eighth Circuits each present well reasoned and logical arguments consistent with the purpose of the existing Truth in Lending law. In light of those decisions this Court should find that the right to unearned insurance premiums is a substantial interest which must be disclosed under TILA and affirm the decision of the Seventh Circuit Court of Appeals now before this Court.

ARGUMENT

I. THE RIGHT TO UNEARNED INSURANCE PREMIUMS IS A SECURITY INTEREST AND MUST THEREFORE BE DISCLOSED AS SUCH

A. Any Security Interest Must Be Disclosed Under The Act And Regulation Z

The Act requires "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates." 15 U.S.C. § 1638(a)(10). Regulation Z defines a "security interest" as "any interest in property which secures payment or performance of an obligation." 12 C.F.R. § 226.2(gg) (1980).

There are no exceptions to, or limitations on, the requirement to disclose all security interests. Where the Act and implementing regulation use the term "any," the attempt to have that language read to mean "certain" is misdirected advocacy. If the right to unearned insurance premiums is a security interest as defined by the Act and Regulation Z, then Petitioner's failure to disclose it as required violated the Act.

B. The Circuits Have Found And Petitioner Concedes That The Right To Unearned Insurance Premiums Is a A Security Interest

All five circuit courts of appeal to consider the issue have found that the right to unearned insurance premiums is a security interest for the purposes of TILA.[1]

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[1] *James* v. *Ford Motor Credit Co.*, —— F.2d —— (10th Cir. 1980); *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556, 558, 559 (8th Cir. 1980); *Valencia* v. *Anderson Bros. Ford*, 617 F.2d 1278, 1281, 1286 (7th Cir. 1980); *Souife* v. *First National Bank of Com-*

Four of the five circuits have held that the failure to disclose a security interest in unearned insurance premiums as part of the required Truth in Lending disclosures constituted a violation of the Act.[2]

In *Valencia* v. *Anderson Bros. Ford*, 617 F.2d 1278, 1284 (7th Cir. 1980), the Court saw that the starting point of any analysis had to be the definition of a "security interest" in Regulation Z. That definition provided "a straightforward, two step approach to classification of interests for disclosure purposes". *Id.* at 1284. *One, the right conferred must be an interest in property; two, the right must secure payment or performance of an obligation.*

Petitioner conceded in *Valencia* that the right to unearned premiums is an interest in property, albeit incidental. *Id.* at 1285-86. The court had only to read the contract to find that the assigned premiums secured performance or payment of the obligation to maintain insurance coverage. The creditor can use the unearned premiums to purchase replacement insurance. The premiums can also be applied to reduce the outstanding obligation at the creditor's discretion. *Id.* at 1286 n.10. Thus, *Valencia* concluded that the right to unearned premiums "is by definition a security interest for TILA purposes, 12

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merce, 628 F.2d 480, 481, 482-83 (5th Cir. 1980); *Edmundson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291, 293, 294 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) and *Gennuso* v. *Commercial Bank & Trust Co.*, 544 F.2d 437, 440 (3d Cir. 1977). The *James* opinion is reprinted as addendum 27 to Petitioner's Brief.

[2] *Murphy*, 629 F.2d at 560; *Valencia*, 617 F.2d at 1286; *Souife*, 628 F.2d at 483, *Edmundson*, 577 F.2d at 294 and *Gennuso*, 544 F.2d at 440, n.2. Even *James*, the sole circuit court opinion holding that disclosure is not required, admits that the contractual right to unearned premiums creates a security interest under TILA. *James* cites the 1980 amendments to the Act for the proposition the security interest in unearned premiums is not the *type of security interest* that need be disclosed. *James*, Addendum to Petitioner's Brief at 33.

C.F.R. § 226.2(gg), and as such must be disclosed." *Id.* at 1286.

Petitioner still refers to the assignment provision as an "interest in property." Petitioner continues to admit that the right to premiums secures performance of the obligation to maintain insurance, insulating lenders from the risk of damage to the collateral and nonpayment of the underlying debt in the event the collateral is damaged.[3] Petitioner's Brief at 4-5, 9.

C. The Only Position Of The Federal Reserve Board Entitled To Any Deference Is Its Consistent View That The Right To Unearned Insurance Premiums Is A Security Interest Under The Act

Despite the variety of pronouncements in differing forms from the Federal Reserve Board,[4] the Board has consistently maintained that the right to unearned insurance premiums is a security interest.

The first Board pronouncement was an Unofficial Staff Interpretation, FRB Public Position Letter No. 377 issued on July 22, 1970, which addressed an analogous interest in insurance premiums.[5] A creditor proposed to

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[3] "The purpose of an assignment of unearned premiums in physical damage coverage is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles, thereby exposing lenders to the risk of uninsured collateral". Petitioner's Brief at 4-5.

[4] Typically, the Board issues official staff interpretations upon which parties may rely under 15 U.S.C. § 1640(f) as a good faith defense and unofficial staff interpretations which "have no special status under Sec. 1640(f)." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 567, n. 10 (1980).

[5] FRB Public Position Letter No. 377, [1969-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 30,555 (July 22, 1970).

pay for accidental death and dismemberment insurance policies from the proceeds of loans. If the consumer defaulted, the creditor would cancel the policy and apply premium refunds to the unpaid balance of the loan.[6] Letter No. 377 required disclosure of "the loan company's ownership of the policy[7] as a type of security interest under Section 226.8(b)(5)."[8]

The next significant pronouncement was also an Unofficial Staff Interpretation, FRB Public Information Letter No. 1263, issued on November 23, 1977.[9] No. 1263 expresses the staff's opinion that "assignment of re-

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[6] The life insurance policy in No. 377 was a single premium lifetime accidental death and dismemberment policy. That insurance policy is reminiscent of the currently fashionable credit life insurance policy. While this case only involves property risk insurance, the vast majority of automobile retail installment contracts include credit life insurance. *See* text accompanying n. 16, *infra*. *See also Souife* v. *First National Bank of Commerce*, 528 F.2d at 481 (Credit life insurance and property damage insurance purchased).

[7] Petitioner's interest in the property damage insurance is much more substantial than the situation raised in No. 377. Petitioner's interest includes proceeds from the policy, unearned premiums and the right to cancel, to purchase substitute insurance or to settle any claim, applying the proceeds as it sees fit. *Valencia* v. *Anderson Bros. Ford*, 617 F.2d at 1231.

[8] Regulation Z, § 226.8(b)(5) (1980) states in pertinent part: (b) Disclosures in sale and nonsale credit. In any transaction subject to this section, the following items, as applicable, shall be disclosed:

* * * *

(5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

[9] FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 31,736 (November 23, 1977).

turned and unearned premiums may transfer to the creditor such an [security] interest." But No. 1263 did not specifically mandate disclosure of the right to unearned insurance premiums and insurance proceeds, instead deferring to the *courts* to interpret state substantive law and federal disclosure requirements.

Then on May 5, 1980 the Federal Reserve Board issued its first complete revision of Regulation Z designed to implement the 1980 amendments to the Truth in Lending Act. Despite the changes made by the Simplification and Reform Act,[10] the revised Regulation Z defined "security interest" to mean "an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by and enforceable under state law." [11] There was no exception for unearned insurance premiums.

On September 18, 1980, the Board proposed FC-0173, the only Official Staff Interpretation on this issue, subsequently deferred pending consideration of this case.[12] That interpretation *deletes all references to state law* and reiterates that "a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums". The Board then proposed to except disclosure of a security interest in unearned premiums as an "incidental interest" not of the type meant to be covered by Regulation Z, § 226.8 (b) (5).

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[10] Those amendments were enacted as Title V of the Depository Institutions Deregulation and Monetary Control Act, 96-221, 94 Stat. 132. The amendments are known as the Truth in Lending Simplification and Reform Act.

[11] Revised Truth in Lending Regulation Z, § 226.2(bb), CCH Cons. Credit Guide Report No. 304 (May 5, 1980).

[12] Proposed Official Staff Interpretation, FC-0173, September 18, 1980. On December 15, 1980, the Board of Governors of the Federal Reserve System deferred final action on that interpretation.

In December, 1980, the Board issued its second complete revision of Regulation Z. It changed the definition of security interest to include:

> an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by and enforceable under *state and federal law.*

Revised Truth in Lending Regulation Z, § 226.2 CCH Cons. Credit Guide Report No. 319 (December 4, 1980) (emphasis added). The Board still recognized that the interest in unearned insurance premiums was a security interest but excepted it, as in the proposed Official Staff Interpretation, FC-0173, as an "incidental interest."

However, the "incidental interest" doctrine of FC-0173 is not entitled to any significant weight by this Court. This is not the same situation as in *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980). There this Court had before it an *adopted official* staff interpretation of the Federal Reserve Board, as well as several unofficial staff interpretations consistent with the official view.

The absence of an official staff interpretation in this case creates an entirely different situation. Under Regulation Z, 12 C.F.R. § 226.1(d), official staff interpretations are released only after interested parties have had an opportunity to comment upon the interpretation. Courts giving deference to such official interpretations know that the Board has had an opportunity to consider the positions of both creditors and consumers. Unofficial staff interpretations are responses to questions posed by individual creditors or consumers requesting an opinion on a specific set of facts, with no opportunity for comments by other interested parties. The proposed Official Staff Interpretation FC-0173 was withdrawn by the Board after comments were received but before any consideration was given to the comments. To give deference to a proposed but withdrawn staff interpretation would be inappropriate.

Thus these several positions by the Board are certainly consistent in viewing the right to unearned premiums as a security interest under the Act. None of the later pronouncements invoking the incidental interest doctrine have been officially adopted and should have no bearing on this case.

II. EVEN IF THE ACT AND REGULATION Z REQUIRED THAT ONLY SUBSTANTIAL SECURITY INTERESTS NEED BE DISCLOSED AND ONLY WHEN THIS COULD BE DONE WITHOUT CONFUSING CONSUMERS, THE RIGHT TO UNEARNED INSURANCE PREMIUMS WOULD HAVE TO BE DISCLOSED

If we assume with Petitioner that the Act and Regulation Z do not require that *any* security interest be disclosed, then we confront the issues of whether the security interest here is "incidental" and whether its disclosure would confuse, rather than aid, consumers in understanding retail installment contracts.

A. The Right To Unearned Insurance Premiums Is A Substantial Interest

Individual retail installment contracts for automobiles commonly include financing for credit life insurance and credit disability insurance as well as property damage insurance. As a result of this multi-risk coverage, the right to unearned premiums can average hundreds of dollars in each transaction and as such constitutes a substantial economic interest. In the Detroit, Michigan area the average insurance premium for a standard no-fault insurance policy with comprehensive and collision coverage ranges from $477 to $893 per year.[13] The additional

[13] This is based upon a standard no-fault insurance policy with $50.00 deductible comprehensive, $100.00 deductible collision on a mid-priced ($6000-8500) 1980 Chevrolet Impala automobile. The $477.00 figure is for a senior citizen defined as over the age of 65.

coverage for credit life and health and accident insurance averages $775.25.[14] Thus in the retail installment sales contract where all three types of insurance are purchased and financed under the contract, the first year premium ranges from $1,252.25 to $1,628.25 on a midpriced car.[15]

Viewed in the aggregate, this means that vast amounts of money are invested in insurance premiums financed as part of retail installment contracts. Where physical damage insurance is required under the contract, as here, the coverage rate approximates 100%. Similar rates are approached for credit life insurance. As early as 1969, credit life insurance was written in connection with 75% of all consumer credit transactions. American Council of Life Insurance, *Life Insurance Fact Book* 35 (1969). More current estimates indicate that it is not unusual for a creditor to achieve a 100% "penetration rate" in the sale of credit life insurance.[16] Board of Governors of the

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The $893.00 figure is for a single male under 25. Other classifications by age and sex fall between those two figures. State of Michigan, Department of Licensing and Regulation, Insurance Bureau Internal Memoranda. These estimates are based upon rate filings by insurers in September, 1980.

[14] This figure for credit life and credit disability was calculated from tables and formulas supplied by the Michigan Insurance Bureau, Department of Licensing and Regulation. For our example, we assumed a mid-sized automobile with a purchase price of $6,500.00. The credit disability coverage provided is one with a fourteen day waiting period with retroactive benefits and covering pre-existing medical conditions. The credit life insurance in this situation is $258.42 and credit disability costs the consumer $516.83. A 48 month contract was assumed.

[15] These statistics correspond to those in the reported cases. In *Valencia*, 617 F.2d at 1281 the cost of physical damage coverage was $442.00 on a $1,340.00 used automobile. In *Souife*, 628 F.2d at 480, the consumer purchased property insurance and credit life insurance.

[16] Professor Jonathan Landers in *Determining the Finance Charge Under the Truth in Lending Act*, 1 Am. Bar Foundation Research J. 45, 115 (1977) states: "[I]ndeed in some states it is

Federal Reserve System, *Annual Report To Congress On Truth In Lending For The Year 1976* 34 (1977). The total number of persons insured in 1978 under credit life insurance policies *alone* was 83,725,000. The total amount of insurance was $163,681,000,000. American Council of Life Insurance, *Life Insurance Fact Book* 34 (1979).

The ease with which the unearned premiums can be obtained and used by the creditor also enhances the economic value of the right to unearned premiums. The creditor need only make a demand upon the insurance company. There is no requirement of a judgment. There is no expense or uncertainty involved as there is in a repossession and resale of the collateral. Once obtained:

> The creditor is expressly granted "sole discretion" to apply returned premiums toward payment of the indebtedness; this discretion may, of course, be exercised in the event of default. The creditor may also apply the returned premiums toward substitute insurance on the property, thereby securing the debtor's contractual obligation to obtain and maintain insurance on the vehicle.

Edmundson, 577 F.2d at 294. The creditor is not required to consult the debtor first. Nor must any statutory lien procedures be followed. Essentially the contract gives the creditor the right to use $1200-$1600 of the debtor's money as it sees fit.

In addition to being substantial in the sense of economic value, the right to unearned premiums is also a substantial right when consumer credit transactions are analyzed at a practical level. Ordinarily hundreds of dollars in unearned premiums are available to consumers if they choose to cancel their insurance coverage. Knowl-

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the profit from insurance that keeps many small loan companies in business". (citations omitted) *See also* J. Sheffey, *Credit Life and Disability Insurance Disclosures Under Truth in Lending: The Triumph of Form Over Substance*, 8 Fla. St. U.L. Rev. 463 (1980).

edge that the money from unearned insurance premiums is not available for their use can affect decisions about cancellation of the insurance policy, prepayment of the obligation or default.[17] For example, absent the security interest, a debtor facing a mortgage foreclosure, could cancel the policy. The debtor could then use the rebated premium to make overdue mortgage payments. Or the debtor might elect to apply part of the proceeds to the underlying debt and part to another obligation.

However, having granted the creditor a security interest in the unearned premiums, the debtor no longer has the right to those premiums. Public comments on record with the Federal Reserve Board suggest that consumers are surprised and angry to learn after executing such a contract that the creditor has retained an interest in these monies. Federal Reserve Board, Comments Re Proposed Official Staff Interpretation FC-0173, Public Comment No. 53 (1980).

Also the frequency upon which the contract term is relied is an indication of its importance. It is the experience of *Amicus* that creditors, upon default and repossession of automobiles under consumer contracts, routinely apply for and receive insurance premium rebates. While the contract clause only refers to physical damage coverage, creditors regularly obtain rebates on all insurance financed including credit life and accident and health policies.

Thus from an economic or practical viewpoint the right to unearned insurance premiums is a substantial right. At either an individual level or looking to the aggregate amount of insurance financed, large sums of money are

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[17] Congressional concern over security interests was not limited to curbing abuses in connection with consumer loans secured by second mortgages on residences. Petitioner's Brief, at 11-14. Otherwise Congress need not have enacted 15 U.S.C. § 1637(a)(7), 15 U.S.C. § 1638(a)(10) and 15 U.S.C. § 1639(a)(8).

involved. Practically speaking the creditor's interest in unearned premiums affects consumer decisions about default on this or other credit obligations. Finally, the frequent use of the clause by creditors to claim unearned premiums signifies that it is a term essential to the relationship of the parties. In light of the above any characterization of the right to unearned insurance premiums as an "incidental and ephemeral right" ignores the reality of consumer credit transactions.

B. Disclosure Of The Security Interest In Unearned Insurance Premiums Need Not Result In Any Confusion To Consumers

It is within the control of those who draft retail installment contracts to determine how confusing those documents will be to consumers. Arguments for nondisclosure by the drafters based on avoiding consumer confusion must be received with some skepticism.

Professor Jeffrey Davis in his article, *Protecting Consumers From Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer Credit Contracts*, noted that the ability of a consumer to understand any item of information in a contract depends on three major characteristics of the document. They are information load, readability and conceptual difficulty.[18] This Court was quite correct in *Milhollin* when it stated that "meaningful disclosure does not mean more disclosure." [19] However, meaningful disclosure does not necessarily mean less disclosure.

Studies have demonstrated that the level of understanding increases as the information load increases, to

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[18] J. Davis, *Protecting Consumers From Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer Credit Contracts*, 63 U. Va. L. Rev. 841, 846-56 (1977) [hereinafter cited as J. Davis].

[19] *Milhollin*, 444 U.S. at 568.

an optimum level. Furthermore, each person's level of understanding peaks at approximately the same information load.[20] While it is a legitimate concern that the optimum information load is not exceeded, at least one study indicates that the "readability" of the information disclosed is more critical to understanding than the amount of information.

To test the significance of "readability", or the method of presentation, Professor Davis conducted empirical tests based on consumer contracts. He redrafted a typical retail installment contract, utilizing fewer, less complicated words. His test subjects understood the simplified contract 26% better than those subjects reading a typical contract. For example, 54.8% of the test subjects reading the *typical contract* understood the buyer's right to a rebate of interest charges upon repayment. Yet 80% of the test subjects reading the *simplified contract* understood that same right.[21]

Professor Davis then conducted another test. He drafted a contract deleting the excess disclosures but not altering the typical "legalese". He labelled it "less disclosure". He then drafted another contract which contained all of the disclosures, except it was drafted for "readability". The test subjects understood the "readable" contract much better than the "less disclosure" contract.[22] In that case less disclosure was in fact not better disclo-

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[20] J. Davis, at 848-49.

[21] J. Davis, at 876.

[22] The mean score on the "Less Disclosure" (LD) contract was 8.47. The mean score on the "Readable" (R) contract was 9.84. The probability that this difference is the result of random error was 0.01. Therefore the result was statistically significant. *See* J. Davis, at 869 n. 89.

sure. Simplification through redrafting was a much more effective aid to understanding. [23]

The contract clause in question is a good example of the importance of "readability." *Amicus* tested the reading level of the right to unearned premiums clause utilizing the Flesch formula.[24] Out of a score of 100, where 100 represents an extremely readable document, that clause scored 25.5.[25] The minimum score necessary to meet the Plain English Standard is 60. 25 scores at the low end of Difficult.[26] Stated another way, a score of 25 means that the contract clause tested at a college graduate reading level.[27] Even more telling is the contract

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[23] *Id.* at 887. That same group was also tested on the "Typical" and "Simplified" contracts. The score on the "Typical" contract was 7.74 and the score on the "Simplified" contract was 9.78. The closeness of the scores on the "Readable" and "Simplified" contracts is interesting. The "Readable" contract contained all the disclosures and was 630 words. The "Simplified" contract contained fewer disclosures and was 480 words. Again less is not necessarily better. *See* J. Davis, at 866, 886.

[24] R. Flesch, *How To Write Plain English* (1979). That formula measures readability according to sentence length and the number of syllables per word. Both have been shown to have predictive [illegible]e. *See* J. Davis, at 852.

[25] R. Flesch, *How To Write Plain English*, at 25. The Flesch test first appeared in R. Flesch, *A New Readability Yardstick*, 32 J. Applied Psych. 221 (1948).

[26] R. Flesch, *How To Write Plain English* at 26. This result is consistent with the "typical" contract used by Professor Davis. It also tested out at an above college graduate reading level on the Flesch formula. J. Davis, at 866.

[27] The contract clause used by Ford Motor Credit Company reads as follows:

> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance

clause used by one of the *Amici*, General Motors Acceptance Corporation. That paragraph is comprised of a single sentence, *273 words long*. It scored an amazing minus (-) 194 on the Flesch test.[28]

Professor Davis refers to the language typified by Petitioner's and Amici's contracts as "gobbledygook". If creditors were truly concerned with achieving meaning-

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or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

[28] The contract clause used by General Motors Acceptance Corporation reads as follows:

(c) In the event that a charge for the required physical damage insurance protecting all interest hereunder is an item hereinabove included in the obligation payable under this contract or a charge for such insurance becomes included therein at any time hereafter under subparagraph (a) hereof, and in the further event that (1) the insurance company to which the seller is authorized to apply therefor refuses to issue such insurance, or (2) subsequent to issuance thereof and during the term of this contract such insurance is cancelled, then the seller shall apply either an amount equal to the aforesaid insurance charge in the case of (1) above, or in the case of (2) above an amount equal to the unearned portion of the premium for such insurance upon seller's receipt thereof from the insurer pursuant to authorization hereby given therefor, as a credit in reduction of that portion of the total of payments which comprises so much of one or more of the instalments payable on the latest due dates (including the final due date) hereunder as equals the amount herewith provided to be applied, it being understood and agreed that the order of applying said amount to said instalments shall be inverse to the order in which they are payable hereunder and that, in the further event that the seller procures insurance covering solely the interest of seller hereunder pursuant to the provisions next herein set forth in subparagraph (d), the amount to be credited and applied in the aforesaid events shall be reduced by an amount equal to the cost of such insurance covering solely the interest of the seller hereunder.

ful disclosure and promoting the informed use of credit, the first step *would not be* to delete significant disclosures. Redrafting for "readibility" would be the first priority. As Professor Davis discovered, the complicated and wordy consumer contracts can be successfully rewritten to contain all important disclosures and actually increase consumer understanding.

Accordingly, there need be no confusion of consumers by requiring the disclosure of the right to unearned insurance premiums. In fact by informing the consumer of an important contract term, the consumer's understanding of their relationship with the creditor will be enhanced.

CONCLUSION

The Third, Fifth, Seventh and Eighth Circuits have each presented well reasoned and logical arguments consistent with the purpose of TILA. The straightforward, two step approach advocated by those opinions is compelling.

15 U.S.C. § 1638(a)(10) requires disclosure of security interests. Regulation Z, 12 C.F.R. § 226.2(gg) defines a security interest as an interest in property that secures payment or performance of an obligation. Each of the circuits to consider the issue have found that right to unearned insurance premiums meets that definition of a security interest.

There is no exception in either the Act or the Regulations for "incidental" interests even if this was one. The Act allows the Federal Reserve Board to make an exception. It could have but failed to do so for security interests in unearned insurance premiums. In any event this security interest is not an incidental one. The right to $1,650.00 in unearned insurance premiums is a significant economic right to consumers with substantial practical consequences for the relationship between the parties.

Despite the current concern over information overload, that concern should play no role in deciding this issue. Studies show that the method used to present information is more important to consumer understanding than the number of contract terms. In light of those studies this Court should not underestimate the ability of consumers to understand contractual terms given proper, readable contracts.

Therefore, *Amicus* urges this Court to affirm the decision of the Seventh Circuit and find that the right to unearned insurance premiums and proceeds is a security interest that must be disclosed under TILA.

Respectfully Submitted,

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